# Technical bulletin 2011/1

January to March 2011

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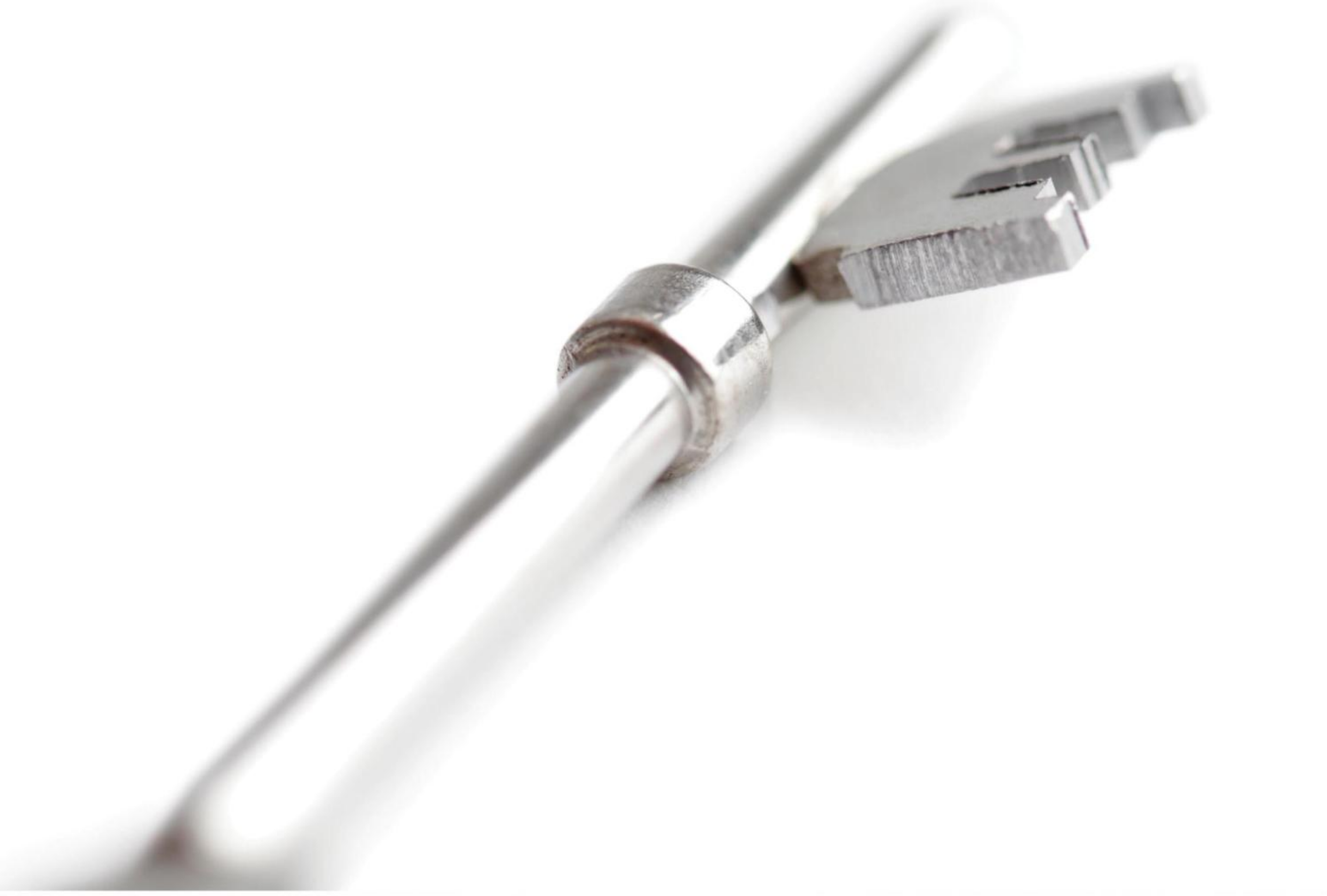

AUDIT SCOTLAND

# Contents

# Foreword

Audit Scotland's Technical Services Unit (TSU) provides guidance and support to external auditors appointed by the Accounts Commission and Auditor General to assist them fulfil their responsibility under their audit appointment to give an opinion on the financial statements.

This includes the publication of technical bulletins (TBs) at quarterly intervals onto the TSU intranet/extranet. The purpose of TBs is to summarise technical developments in the quarter for external auditors, and to provide auditors with guidance where required.

TBs frequently recommend that auditors take certain actions, and a summary of these actions is provided at the end of each chapter. It is important that a mechanism is in place for senior audit staff to review the TB promptly and to ensure that steps are taken to consider such recommendations.

While auditors act independently of Audit Scotland, and are responsible for their own conclusions and opinions, consistency of opinions in similar circumstances is important and **it is expected therefore that auditors will normally follow all TSU guidance. Auditors should advise the TSU promptly if they disagree with, and may intend not to follow, any guidance issued on an important issue** (e.g. a matter that required consideration to be given to the qualification of the accounts of a number of audited bodies).

TBs are also published on the Audit Scotland website so that audited bodies and other stakeholders can be aware of the guidance that has been issued to auditors. In selecting items for inclusion in TBs the bias is towards those which are of particular interest to external auditors. TBs should not therefore be regarded as providing an exhaustive review of all matters relevant to audited bodies.

Audit Scotland makes no representation as to the completeness or accuracy of the contents of TBs or that legal or technical guidance is correct. Points of law, in particular, can ultimately be decided only by the Courts. Audit Scotland accepts no responsibility for any loss or damage caused as a result of any person relying upon anything contained in a TB.

# Cross-sectoral chapter

## Introduction

This chapter contains articles on cross-sectoral technical developments and guidance relevant to external auditors' responsibilities under their audit appointment to give an opinion on the financial statements. It should be read by all external auditors. Developments and guidance that are relevant to only one sector are covered in the relevant sector-specific chapter. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance, urgent issue notes and, for local authorities, grant notes).

The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to auditors on the TSU intranet/extranet.

In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that the following articles in this chapter relate to 2010/11 audits

- note for guidance on severance schemes
- guidance on replacing the retail price index for retirement benefits
- a new management commentary practice statement
- revised auditing practice notes
- revised standard and bulletin on auditor's reports.

There are also articles in this chapter on the following subjects: amendments to standards on IFRS adoption; amendment to standard on deferred tax; exposure draft on public benefit entities; exposure draft on hedge accounting; exposure draft on offsetting financial instruments; amendment to exposure draft on impairment of financial instruments; good practice capital disclosures; discussion paper on the effects of accounting standards; revised ethical standards; revised guidance on audit committees; revised practice notes on pension schemes, bank reports, stocktaking, and charities; proposed standard on reviewing historical financial statements; proposed standard on greenhouse gas statements; discussion paper on auditing disclosures; guidance on applying governance code; regulations on Scottish charitable incorporated organisations; and a revised code of practice on freedom of information.

The TSU encourages feedback on this TB. Comments should be sent to alewis@audit-scotland.gov.uk.

# TSU developments

## Publications

The following note has been published by the TSU since TB 2010/4 and is available to auditors on the TSU intranet/extranet. It can be sent to other TB recipients on request.

### Note for guidance on severance schemes

The TSU has published *Note for guidance 2011/1 Severance schemes* to provide auditors with guidance on reviewing severance schemes at audited bodies.

# Accounting developments

The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to auditors on the TSU intranet/extranet.

## Guidance on replacing the retail prices index with the consumer prices index for retirement benefits

The Urgent Issues Task Force has issued *UITF abstract 48 Accounting implications of the replacement of the retail prices index with the consumer prices index for retirement benefits* to provide guidance on replacing the retail prices index (RPI) with the consumer prices index (CPI) for retirement benefits. The abstract is in response to the UK government's announcement in June 2010 of the intention to move to using the CPI as the inflation measure for determining the minimum pension increases to be applied to the statutory index-linked features of retirement benefits. Although written in the context of *FRS 17 Retirement benefits*, the abstract notes that entities preparing financial statements in accordance with international financial reporting standards (IFRS) may refer to the abstract as a source of guidance.

The extract states that recognition of the change is dependent on whether there is an obligation to pay pensions with increases based on at least the RPI, or more generally with inflation–linked increases. Scheme liabilities comprise benefits promised under the formal terms of the scheme but also any constructive obligation for further benefits that has created a valid expectation that such benefits will be granted. An obligation may therefore exist where associated literature makes reference to RPI or where the general understanding of scheme members is that increases would be calculated using RPI. The nature of any obligation to members may vary and will depend on a number of factors, including the nature and content of the employer's communications with members. An entity may therefore need to apply judgement in determining if it has an obligation to pay benefits based on RPI. The change may therefore be accounted for as follows

- Where the scheme liabilities are linked to at least RPI, the change to these liabilities is a change in benefit and gives rise to a past service cost, which should be recognised in the accounting period when necessary consultations have been concluded i.e. when the change has been agreed and announced.

- Where scheme liabilities are not linked to at least RPI, a change to CPI is a change in the assumption about inflation used to measure the liabilities and represents an actuarial gain or loss.

Auditors should confirm that their bodies are aware of this guidance and are complying with its requirements. Auditors with bodies in the local government pension scheme may also wish to note that the Chartered Institute of Public Finance and Accountancy is preparing guidance which applies the abstract to that scheme.

## New management commentary practice statement

The International Accounting Standards Board (IASB) has issued an *IFRS practice statement - Management commentary - A framework for presentation* to provide a framework for the presentation of a management commentary prepared under IFRS. The management commentary is a narrative report that provides a context for interpreting the financial position, financial performance and cash flows of an entity. The practice statement applies from 8 December 2010 in the private sector and provides guidance on the principles, qualitative characteristics and elements of a management commentary that are necessary to provide users of financial reports with useful information.

A management commentary should communicate information about the entity's resources and the claims against the entity, and the transactions that change them. It should also explain the main trends and factors that are likely to affect the entity's future performance, position and progress, and should therefore look not only at the present, but also at the past and the future. It should provide information that is essential to an understanding of

- the nature of the business
- management's objectives, and its strategies for meeting those objectives
- the entity's most significant resources, risks and relationships
- the results of operations and prospects
- the critical performance measures and indicators that management uses to evaluate the entity's performance against stated objectives.

A management commentary should be presented with a focus on the most important information in a manner intended to address the principles described in the statement. Specifically

- It should be consistent with the related financial statements.
- Management should avoid duplicating in the management commentary the disclosures made in the notes.
- Management should avoid generic disclosures that do not relate to the practices and circumstances of the entity and immaterial disclosures that make the more important information difficult to find.

It has not yet been decided whether this practice note will apply in the public sector.

## Amendments to standard on IFRS adoption

The IASB has issued *Severe hyperinflation and removal of fixed dates for first-time adopters – Amendments to IFRS 1* which makes two minor amendments to *IFRS 1 First-time adoption of international financial reporting standards*

Firstly, it replaces references to a fixed date of '1 January 2004' with 'the date of transition to IFRS', which eliminates the need for entities adopting IFRS for the first time to restate derecognition transactions that occurred before the date of transition to IFRS.

It also provides guidance on how an entity should resume presenting financial statements in accordance with IFRS after a period when its functional currency was subject to severe hyperinflation.

The amendments are available to subscribers to the IASB website. They are effective from 1 July 2011, with earlier application permitted.

## Amendment to standard on deferred tax

The IASB has issued an amendment to *IAS 12 Income taxes* called *Deferred tax: Recovery of underlying assets (Amendments to IAS 12)* on the measurement of deferred tax.

Under IAS 12, the measurement of deferred tax liabilities and assets depends on whether an entity expects to recover an asset by using it or selling it. The amendment introduces a presumption that an asset measured at fair value is recovered entirely through sale unless the entity has clear evidence that recovery will occur in another manner.

The amendments are available to subscribers to the IASB website.

## Exposure draft on public benefit entities

The Accounting Standards Board (ASB) has issued *FRED 45 Financial reporting standard for public benefit entities* to set out proposals for financial reporting requirements for public benefit entities (PBEs). A PBE is defined as an entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided to support the entity's primary objectives rather than providing a financial return to shareholders.

The standard is being developed to address some transactions that are specific to the PBE sector. PBE SORPs are expected to be updated following publication of this standard and will continue to provide sector specific interpretation and guidance where necessary. The draft standard proposes that

- concessionary loans (i.e. loans made or received at below the prevailing market rate of interest which are not repayable on demand) should be recorded at either fair value or the amount received or paid
- property held for the primary provision of social benefits, e.g. social housing, should be accounted for as property, plant and equipment rather than as investment properties
- merger accounting should be required where specific criteria are met, and clarifies the accounting treatment for combinations that are in substance a gift
- PBEs should be able to apply an alternative method in determining the value in use of assets held for their service potential rather than to generate cash inflows
- an entity should recognise a liability where it has made a commitment that it will provide resources to another party if, and only if, the obligation is such that the entity cannot realistically withdraw from it, and the commitment does not depend on the performance of the recipient. Commitments made which are performance-related will be recognised when those performance conditions are met
- incoming resources (including goods and services) from non-exchange transactions should be recognised at fair value on receipt unless there are performance conditions to be considered. Guidance is provided on the recognition of liabilities, services and performance conditions.

Comments should be sent to asbcommentletters@frc-asb.org.uk by 31 July 2011. It is proposed that entities should apply the final standard for accounting periods beginning on or after 1 July 2013.

## Exposure draft on hedge accounting

The IASB has issued *ED/2010/13 Hedge accounting* which proposes significant changes to general hedge accounting requirements. The exposure draft is the third phase of the project to replace *IAS 39 Financial instruments: Recognition and measurement* with *IFRS 9 Financial instruments*, and is intended to provide more useful hedge accounting information.

It proposes that the objective of hedge accounting is to represent the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss. It also proposes that

- a non-derivative financial asset and financial liability measured at fair value through profit or loss may be eligible for designation as a hedging instrument
- an entity may designate all changes in the cash flows or fair value of an item as the hedged item in a hedging relationship
- a hedging relationship should meet specified hedge effectiveness requirements to qualify for hedge accounting
- for fair value hedges, the gain or loss on the hedging instrument and the hedged item should be recognised in other comprehensive income.

It is proposed that these requirements for hedge accounting should be applied prospectively. Comments were required by 9 March 2011.

## Exposure draft on offsetting financial instruments

The IASB has issued *ED/2011/1 Offsetting financial assets and financial liabilities* which contains proposals on offsetting financial instruments. Under the proposals, an entity would be required to offset (i.e. present as a single net amount) a financial asset and a financial liability when it

- has an unconditional and legally enforceable right of set-off; and
- intends either to settle the asset and liability on a net basis or to realise the asset and settle the liability simultaneously.

A right of set-off must be legally enforceable and it must not be contingent on a future event. The proposals would require an entity to disclose information about offsetting and related arrangements to enable readers to understand the effect of those arrangements on its financial position. In all other circumstances, an entity's financial assets and financial liabilities should be presented in the statement of financial position separately from each other.

If confirmed, the proposed requirements would affect all entities that hold all types of financial instruments within the scope of *IAS 39 Financial instruments: Recognition and measurement*, and would supersede the requirements on offsetting in *IAS 32 Financial instruments: Presentation*.

Comments should be submitted via the IASB website by 28 April 2011.

## Amendment to exposure draft on impairment of financial instruments

The IASB has issued *Supplement to ED/2009/12 Financial instruments: Impairment* which proposes some changes to a previous exposure draft *Financial instruments: Amortised cost and impairment* on the impairment of financial instruments (see TB 2009/4 – page 8).

The original exposure draft considered impairment to be part of the measurement of financial assets at amortised cost after their initial recognition. The primary objective was to reflect initial expected credit losses as part of determining the effective interest rate. It therefore concluded that it was not appropriate to recognise all expected credit losses immediately. However, responses to the original exposure draft indicated that the use of an integrated effective interest rate would be complex.

This supplement therefore excludes expected credit losses when determining the effective interest rate, and instead contains a modified proposal which is intended to approximate the outcomes of the original exposure draft.

Comments should be submitted via the IASB website by 1 April 2011.

## Good practice capital disclosures

The Financial Reporting Council (FRC) has issued a report called *Financial capital management disclosures* which recommends good practice disclosures for capital. The report arises from a study of the capital disclosures in the accounts of 40 listed companies, and notes that companies that scored highly for their disclosures provided

- an analysis of capital that was integrated into discussions about strategy, business model and the resources necessary to deliver on that strategy, and was linked to the amounts reported in the balance sheet or other notes
- a discussion of different sorts of capital and how they were used to manage the capital profile over time
- key policies for capital management such as target ratios including key performance indicators.

## Discussion paper on the effects of accounting standards

The ASB and the European Financial Reporting Advisory Group have issued *Considering the effects of accounting standards - discussion paper* which discusses how standard-setters can consider the consequences that flow from accounting standards (i.e. their effects) as they are developed.

The discussion paper proposes that standard-setters should undertake a systematic effects analysis as part of the standard-setting process, with the following key principles underpinning the analysis

- Standard-setters should explain the intended outcomes of a proposed accounting standard at the agenda-setting stage.
- Constituents should be actively encouraged to provide input on anticipated effects, which should be considered against the standard-setter's objective.
- The evidence gathered should demonstrate that the proposals faithfully represent the underlying economic reality and produce useful information, and the effects should be quantified where practicable.
- Consideration of the effects should occur throughout the standard-setting process; it should be embedded in that process and not considered as a single event.

Comments should be sent to commentletters@efrag.org by 31 August 2011.

## Auditing developments

The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to auditors on the TSU intranet/extranet.

### Revised standard and bulletin on auditor's reports

The Auditing Practices Board (APB) has issued *ISA (UK and Ireland 700) (Revised) The auditor's report on financial statements* which contains changes to the auditor's report on financial statements. The revised standard applies to the audit of periods ending on or after 23 March 2011, with earlier adoption encouraged. Under ISA 700, auditors can choose to refer to the APB website description of an audit in their auditor's report or incorporate the short form description. The APB has

- replaced the previous company-specific descriptions with a generic description that can be applied to all entities
- amended the short form description to refer to the auditor's responsibility to read the narrative information in annual reports.

The APB has also issued *Bulletin 2010/2 Compendium of illustrative auditor's reports on UK private sector financial statements for periods ended on or after 15 December 2010 (revised)* to reflect the revised version of ISA 700.

## Revised ethical standards

The APB has issued revised *Ethical standards for auditors* which become effective on 30 April 2011.  A key change is in respect of the disclosures of fees for non-audit services in financial statements.  A new category of non-audit services has been introduced called 'audit related services' where the threats to the auditor's objectivity and independence are clearly insignificant.  Audit related services include

- reporting required by law or regulation to be provided by the auditor
- reporting on government grants
- reporting on internal financial controls when required by law or regulation
- extended work undertaken at the request of those charged with governance on financial information and/or financial controls performed where this work is integrated with the audit work and is performed on the same principal terms and conditions.

## Revised guidance on audit committees

The FRC has issued a revised edition of its *Guidance on audit committees* which arises from the work undertaken by the APB on the provision of non-audit services (see previous article).  They are intended to address any perception that confidence in the audit is reduced where non-audit services are provided by the auditor, and include the following

- More prominence is given to the importance of non-audit services in the assessment of the objectivity and independence of the company's auditor.
- Additional guidance is given to help the audit committee distinguish between those non-audit services which are closely related to an audit and which give rise to a very low threat to auditor objectivity and those where the threats need more careful consideration.  This is consistent with the identification of 'audit related services' as a separate category of non-audit services in the APB's *Ethical standards for auditors*.
- Improved disclosures which give more detail on the nature of services provided by the auditor which outline the reasons why the audit committee decided to purchase non-audit services, other than audit related services, from the auditor rather than from another party.

## Revised practice notes

The APB has issued the following practices notes which have been updated as a result of the publication of the clarified international standards on auditing (ISAs)

- *Practice note 11 The audit of charities (Revised)*
- *Practice note 15 The audit of occupational pension schemes in the UK (Revised)*
- *Practice note 16 Bank reports for audit purposes in the United Kingdom (Revised)*
- *Practice note 25 Attendance at stocktaking (Revised)*.

## Proposed standard on reviewing historical financial statements

The International Auditing and Assurance Standards Board (IAASB) has issued a draft of *ISRE 2400 (Revised) Engagements to review historical financial statements* on reviewing historical financial statements. It describes a review of historical financial statements as a distinct assurance engagement in which the work effort is substantially different from that applied in an audit, particularly regarding the types of procedures performed and their nature and extent.

The proposed standard states that the practitioner's objective in a review of historical financial statements is to conclude whether anything has come to the practitioner's attention that causes them to believe the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework.

The practitioner draws their conclusion by performing primarily inquiry and analytical procedures, and evaluating the sufficiency and appropriateness of evidence obtained. The proposed standard makes clear that the nature and extent of these procedures is always designed with the individual entity's characteristics and circumstances in mind. Accordingly, there is no set of procedures to be performed in every review, and therefore, unlike the extant standard, the proposed standard does not contain a list of illustrative procedures.

The assurance obtained to support the practitioner's conclusion on the financial statements is limited. To properly communicate the limited assurance, practitioners are required to conclude and report on the financial statements in the form required under the proposed standard. The practitioner's report describes the work undertaken in a review with reference to the primary types of procedures performed, and states the circumstances when additional procedures need to be performed.

Comments should be made via www.ifac.org by 20 May 2011.

## Proposed standard on greenhouse gas statements

The IAASB has issued *Proposed IASE 3410 Assurance engagements on greenhouse gas statements* on providing assurance on greenhouse gas (GHG) statements. The proposed standard is based on a consultation paper published in October 2009 (see TB 2009/4 – page 18), and changes made as a result of the consultation include the following

- The proposed standard now covers limited assurance engagements in addition to reasonable assurance.
- Guidance has been included on the requirement to determine whether it is necessary to perform procedures on location at significant facilities.
- A distinction is drawn between scientific uncertainty and estimation uncertainty, and the assurance report is required to include a reference to uncertainty regardless of the disclosures included in the explanatory notes to the GHG statement.

Comments should be made via www.ifac.org by 10 June 2011.

## Discussion paper on auditing disclosures

The IAASB has issued a discussion paper called *The evolving nature of financial reporting: Disclosure and its audit implications* on auditing disclosures in the financial statements.

Many disclosures are derived from the accounting system and are likely to be included in the audit of the items on the face of the financial statements. However, financial reporting disclosure requirements have recently shifted away from simply providing breakdowns of line items on the face of the financial statements, to providing more detailed disclosures, including disclosures of assumptions, models, alternative measurement bases and sources of estimation uncertainty. This poses challenges for auditors in determining how auditing standards and underlying concepts, such as materiality, apply to their consideration of disclosures.

The paper discusses what constitutes sufficient appropriate audit evidence in relation to different categories of financial statement disclosures, and how to apply materiality to, and evaluate misstatements in, disclosures. It suggests that the identification and assessment of the risk of material misstatement for those disclosures that are not derived from the accounting system will necessitate a separate exercise, as will consideration of the understandability of disclosures.

The paper also discusses the perception that auditors may not be exercising sufficient judgment regarding disclosures in the financial statements. There is a view that auditors may not sufficiently challenge management and those charged with governance about whether all necessary disclosures are included in the financial statements, particularly in respect of major transactions. Alternatively, there is a perception that auditors focus solely on completeness without applying judgment regarding whether all of those disclosures are necessary in the context of that specific entity.

Comments should be submitted via the IAASB website by 1 June 2011.

# Corporate governance developments

The document referred to in the following article can be obtained by using the hyperlink, and is available to auditors on the TSU intranet/extranet.

## Guidance on applying governance code

The FRC has issued *Guidance on board effectiveness* which is intended to assist organisations apply the *UK Corporate governance code*. This guidance relates primarily to sections A and B of the code on the leadership and effectiveness of the board. It is not prescriptive, but is intended to stimulate boards' thinking on how they can carry out their role most effectively.

The guidance is intended to help boards think about the way in which they carry out their role and the behaviours that they display, as well as the structures and processes that they put in place. For example, boards are encouraged to consider how the way in which decisions are taken might affect the quality of those decisions, and the factors to be taken into account when constructing the board and reviewing its performance.

# Other developments

The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to auditors on the TSU intranet/extranet.

## Charities

### Regulations on Scottish charitable incorporated organisations

*The Charities and Trustee Investment (Scotland) Act 2005 (Commencement No. 5) Order 2011* has brought into force the provisions of the *Charities and Trustee Investment (Scotland) Act 2005* that establish a new incorporated legal form that charities may choose to adopt, known as a Scottish charitable incorporated organisation (SCIO). This enables a charity to become a corporate body while continuing to be regulated by the Office of the Scottish Charity Regulator. The Order brings into force the provisions which relate to SCIOs as follows

- Section 64 of the Act came into force on 21 January 2011 and allows the Scottish Ministers to make regulations setting out further provision in relation to SCIOs.

- Sections 50 and 52 of the Act came into force on 21 January 2011 for the purpose of enabling regulations to be made. Section 50 allows the Scottish Ministers to make regulations specifying other matters (beyond those in that section) which a SCIO's constitution must contain. Section 52 allows the Scottish Ministers to specify in regulations the documents on which a SCIO's name must appear.

- Sections 50 and 52 come into force for all other purposes on 1 April 2011, as do sections 49, 51, 53 to 55, 62 and 63.

*The Scottish Charitable Incorporated Organisations Regulations 2011* have been issued under the Act and set out how a SCIO will work from 1 April 2011. The regulations specify that a SCIO's constitution must make provision about

- any restrictions on its powers
- the organisational structure of the SCIO
- its procedural rules for meetings
- the processes for withdrawal and removal of members and of charity trustees
- procedures for dealing with any conflict of interest.

The regulations also place a duty on a SCIO to keep a register of its current and former charity trustees and, where they are different, a register of members, and they specify the information that must be kept on the registers.

The regulations specify that the documents on which a SCIO must state its name, and the fact that it is a SCIO, include business letters and emails; statements of account prepared in accordance with *The Charities Accounts (Scotland) Regulations 2006*; and contractual documentation.

## Freedom of information

### Revised code of practice

The Scottish Government has issued a revised *Code of practice on the discharge of functions by Scottish public authorities under the Freedom of Information (Scotland) Act 2002 and The Environmental Information (Scotland) Regulations 2004* to provide guidance to Scottish public authorities on discharging their responsibilities under freedom of information and access to environmental information legislation. It supersedes two existing codes issued under each piece of legislation, and is more concise than these codes as it avoids repetition of the statutory requirements contained in the legislation, and duplication with guidance that has been developed by the Scottish Information Commissioner.

It stresses in particular the best practice to be followed in providing advice and assistance to requesters, and promotes the importance of proactively publishing information. Additionally, it sets clear expectations on the disclosure of the full financial implications of long term and high value contracts.

# Legislation

The following items of legislation can be obtained by using the hyperlink, and are available to auditors on the TSU intranet/extranet.

## Statutory instruments

### Public finance and accountability

*The Budget (Scotland) Act 2010 Amendment (No 2) Order 2010, SSI 445* came into force on 9 December 2010 and amended the *Budget (Scotland) Act 2010* with respect to 2010/11.

*The Budget (Scotland) Act 2010 Amendment Order 2011, SSI 212* came into force on 16 March 2011 and further amended the *Budget (Scotland) Act 2010* with respect to 2010/11.

### Charities

*The Scottish Charitable Incorporated Organisations Regulations 2011, SSI 44* come into force on 1 April 2011. See Other developments – Charities – Regulations on Scottish charitable incorporated organisations.

*The Charities and Trustee Investment (Scotland) Act 2005 (Commencement No. 5) Order 2011, SSI 20.* See Other developments – Charities – Regulations on Scottish charitable incorporated organisations.

# Publications

The following publications can be obtained by using the hyperlinks.

## Audit Scotland

### The cost of public sector pensions in Scotland

This report *The cost of public sector pensions in Scotland* covers the six main public sector pension schemes in Scotland. It sets out the key features of the schemes, how costs are controlled and the governance arrangements. Key messages include

- Employers currently pay contribution rates of between 11.5 and almost 25% of pay. Employee contributions vary but on average are around a third of those of employers. There is no clear rationale for some of the variation in contributions between schemes.

- Significant cost pressures have built up in the schemes as a result of people living longer than forecast while long-term interest rate changes have increased the schemes' reported liabilities. Recent reforms and decisions by the UK government should help contain employers' spending in all the schemes.

- Despite growing financial pressures, employers' contributions for the three largest unfunded schemes have remained relatively constant at between 3.4 and 3.7% of the Scottish budget.

### Management of the Scottish Government's capital investment programme

This publication *Management of the Scottish Government's capital investment programme* examines how the Scottish Government is managing its capital investment programme and associated risks. Key messages include the following

- Cost estimating has improved in recent years, though slippage continues to affect many projects. The longest delays occurred in the earlier stages rather than during the delivery stage (which would be more costly).

- The Scottish Government is improving its project monitoring and management of the capital programme. However, the pace of change of some improvements has been slow.

- The Scottish Government is strengthening leadership and oversight of its capital investment programme. An overarching investment strategy that sets out clearly long-term investment needs and constraints would help provide key information for prioritising and planning.

### Edinburgh trams - Interim report

This report *Edinburgh trams - Interim report* provides an update on the progress of the Edinburgh trams project and considers issues for the future. The report is a factual commentary which builds on work completed for the 2009/10 annual audits of Transport Scotland and the City of Edinburgh Council, augmented by further analysis of the project's progress and costs and interviews with key parties. It is intended to be an interim report which might lead to further audit work and another report at a later date.

## Scottish budget

### Scotland's budget documents – the 2010/11 spring budget revision

This publication from the Scottish Government *Scotland's budget documents – the 2010/11 spring budget revision* provides information in support of the 2010/11 spring budget revision.

# Fraud cases

The following is a summary of a fraud case at an audited body that has been reported by auditors to the TSU.

## Expenditure

An employee, in collusion with two others, defrauded a council out of £386,000 over a four year period by making false retirement payments. The employee was able to establish fictitious creditors to receive early retirement lump sums and falsified documentation to initiate payments. The addresses of the fictitious creditors were neighbours of the employee. For one payment, the employee used a line manager's password to electronically authorise payment. The fraud was discovered following the introduction of internal control checks.

The fraud was facilitated by an absence of budgetary control; inadequate scrutiny of accounts; ineffective authorisation routines; absence of proper control application in setting up a creditors in the council's payment system; and insufficient security over passwords.

An action plan has been developed to improve the system. The fraud has been reported to the police and the employee has been formally charged. The council has also commenced disciplinary procedures.

# Auditor action

The following is a summary of items in this chapter of the TB that recommend that auditors take certain actions

| Section | Action |
|---|---|
| Accounting developments – Guidance on replacing the retail prices index with the consumer prices index for retirement benefits | Auditors should confirm that their bodies are aware of the UITF abstract and are complying with its requirements. |

# Local authority chapter

## Introduction

This chapter contains articles on local authority technical developments and guidance relevant to external auditors' responsibilities under their audit appointment to give an opinion on the financial statements and to certify grant claims. It should be read by external auditors with appointments in the local authority sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance, urgent issue notes and grant notes).

The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to auditors on the TSU intranet/extranet.

In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that the following articles in this chapter relate to 2010/11 audits

- note for guidance on pension fund annual reports
- 2010/11 Code guidance notes
- 2010/11 transition guidance
- revised councillors' code of conduct
- remuneration reports regulations
- pension funds statutory guidance
- changes to police balances carry forward limits
- 2010/11 HB COUNT modules.

There are also other articles on: 2011/12 Code; draft statement on role of head of internal audit; and consultation papers on police and fire reform.

# TSU developments

## Publications

The following note has been published by the TSU since TB 2010/4 and is available to auditors on the TSU intranet/extranet.  It can be sent to other TB recipients on request.

### Note for guidance on pension fund annual reports

The TSU has published *Note for guidance 2011/3(LA) Pension fund annual report* to provide auditors with guidance on the audit of the pension fund financial statements (see Other developments – Pension fund – Statutory accounting guidance from 2010/11).

## Response to enquiries

The TSU operates a 'help-desk' for auditors which provides responses to ad hoc technical enquiries. Selected responses are added to the frequently asked questions section of the TSU intranet/extranet and include the following since the publication of TB 2010/4.

### Pension funds

***Is an administering authority required to include a governance compliance statement in its pension fund annual report?***

*The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008* require administering authorities to measure their governance arrangements against the standards set out in guidance from the Scottish Ministers, and set out the reasons for any non-compliance in the governance compliance statement.  Auditors are required to review the governance compliance statement to check whether it complies with the Scottish Ministers guidance and report when it does not.

However, the 2008 Regulations allow an authority the option of giving details of where the statement can be obtained rather than including it in the annual report.  This would mean that auditors could not refer to the statement in their report on the accounts and the necessary audit assurance would not be given. Auditors should therefore strongly encourage authorities to include a governance compliance statement in the pension fund annual report.  Where an authority declines to do so, auditors should expect a statement of internal financial control to be included in the annual report to ensure that minimum corporate governance reporting requirements are met.

## Benefits

***What should auditors do to access housing benefit data held on the DWP's customer information system?***

Auditors are reminded that the TSU emailed them with guidance on 3 May 2010 on the actions they should take in this regard. In summary, the Department for Work and Pensions (DWP) has agreed to allow external auditors 'read only' access to the customer information system (CIS) subject to auditors completing

- the character declaration and confidentiality agreement that was attached to the email
- the e-learning package on the CIS which is available to auditors via local authority systems.

Auditors who require access to the CIS or documents or images from the CIS should therefore have signed a copy of the declaration and be keeping it on file to show local authority officers, if requested. Auditors should also have undertaken the CIS e-learning package and be keeping a record of when the training was undertaken. Auditors who require access to the CIS need only sign one declaration and undertake the e-learning package once to be able to access the CIS in all authorities in their portfolios.

Auditors should ensure they have arrangements in place to comply with these requirements.

# Accounting developments

The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to auditors on the TSU intranet/extranet.

## 2011/12 Code

The CIPFA/LASAAC Local Authority Code Board has issued the *Code of practice on local authority accounting in the UK* for 2011/12 (the Code). The Code specifies the principles and practices of accounting required to give a true and fair view of the financial position and transactions of a local authority, including group financial statements where required. In Scotland, the Code constitutes proper accounting practice under section 12 of the *Local Government in Scotland Act 2003*.

The Code can be downloaded by inhouse audit providers from the TSU intranet. Licensing restrictions prevent it from being available from the extranet, but it can be ordered from the CIPFA shop. The main changes from the 2010/11 Code are in respect of the following

- heritage assets
- exit packages disclosure
- trust funds

- valuation of surplus assets
- leases
- group accounts
- disclosure of new accounting standards.

**Heritage assets**

A new section has been added to the Code (section 4.10) that requires authorities to account for tangible heritage assets in accordance with *FRS 30 Heritage assets*. Heritage assets are those that are intended to be preserved in trust for future generations and are held and maintained principally for their contribution to knowledge and culture. They include historical buildings, archaeological sites, scientific equipment of historical importance, civic regalia, museum and gallery collections and works of art. The following disclosures are required

- an indication of their nature and scale
- the policy for their acquisition, preservation, management and disposal
- the accounting policies adopted
- a summary of transactions disclosing the cost of acquisitions, the value acquired by donation, the carrying value of disposals and proceeds, and any impairment.

Valuations may be made by any method that is appropriate and relevant. However, where it is not practicable to obtain a fair value, heritage assets should be measured at historical cost. Where an authority has information on the cost or value, or can obtain it at a cost commensurate with the benefits, they should be recognised in the balance sheet. Depreciation is not required on heritage assets which have indefinite lives, but the carrying amount should be reviewed where there is evidence of impairment. The following should be disclosed

- a reconciliation of the carrying amount at the beginning and end of the financial period showing additions and disposals, revaluation changes, any impairment losses, and any depreciation
- the date of the valuation, valuation methods used to produce the valuation, and details of valuer etc.

For heritage assets that are not reported in the balance sheet, the reasons why should be explained.

Assets that, in addition to being held for their heritage characteristics, are also used by the authority for other activities or to provide other services are operational assets and should be accounted for as property, plant and equipment.

The definition of community assets (i.e. assets that an authority intends to hold in perpetuity, that have no determinable useful life and which may have restrictions on their disposal) no longer includes items that are now accounted for as heritage assets.  However, an authority may elect to treat community assets in the same way as heritage assets.

The implementation of the heritage assets requirements in the 2011/12 Code, and any election to treat community assets in the same way, represents a change in accounting policy, and authorities should therefore account for the change retrospectively, including the preparation of a balance sheet at the beginning of the earliest comparative period.

**Exit packages disclosure**

A requirement has been introduced at section 3.4 for authorities to report summary information in relation to exit packages, including compulsory and voluntary redundancy costs, pension contributions in respect of added years, ex-gratia payments and other departure costs.  Authorities are required to disclose

- the number of exit packages agreed (grouped in rising bands of £20,000 up to £100,000, and bands of £50,000 thereafter)
- the total cost of packages agreed in each band
- an analysis between compulsory redundancies and other departures.

**Trust funds**

The disclosure requirement regarding trust funds that appeared in the 2009/10 statement of recommended practice (SORP) but that had been omitted from the 2010/11 Code has, at the suggestion of Audit Scotland, been reinstated.  The Code paragraph 3.4.4.1 therefore now requires details of the nature and amount of trust funds to be disclosed where the authority acts as the sole trustee.

**Valuation of surplus assets**

The Code at paragraph 2.1.2.26 clarifies that the fair value of surplus assets should be based on the existing use value of the asset in its last operational use.

**Leases**

Paragraph 4.2.2.8 has been amended to provide guidance in cases where a lessee and lessor agree to change the provisions of the lease.  The Code now states that the revised agreement is normally regarded as a new agreement if the changed terms being in effect at the inception of the lease would have resulted in a different classification of the lease.  However, changes in estimates (e.g. in respect of the economic life or the residual value of the leased property), or changes in circumstances (e.g. default by the lessee) do not give rise to a new classification of a lease for accounting purposes.

The guidance in paragraph 4.2.2.10 on the allocation of minimum lease payments between land and buildings has been clarified.  It now states that the minimum lease payments should be allocated in proportion to the relative fair values of the leasehold interests, rather than the fair values of the land buildings.

Guidance on lease classification at paragraph 4.2.2.7 has been updated to include the following three additional indicators that could lead to a lease being classified as a finance lease

- The lessor's losses associated with a cancellation by the lessee are borne by the lessee.
- Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee, e.g. in the form of a rent rebate equalling most of the sales proceeds at the end of the lease.
- The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

**Group accounts**

In section 2.5, the term 'machinery of government changes' has been replaced with 'combination of public sector bodies'.

Paragraph 2.5.1.1 has been amended to confirm that combinations of public sector bodies, which are excluded from IFRS 3's requirements for acquisition accounting, apply to transfers of functions between any public sector bodies, and not just between local authorities.

Paragraph 2.5.2.3 incorporates guidance on the transfer of functions to non-public sector bodies (e.g. social enterprises).  It requires such transfers to be accounted for by derecognising any assets and liabilities transferred to the non-public sector body, and requires any income received to be accounted for as proceeds of sale of the asset.  Paragraph 2.5.4.3 requires the disclosure of the circumstances of any transfer of assets and liabilities to a non-public sector body arising from the transfer of one or more functions to that body.  The disclosure should include details of the assets and liabilities transferred, and their carrying amounts.

Paragraph 9.1.2.46 has been added to cover instances where an authority is a party to a joint venture, and has significant influence, but not joint control.  It requires the authority to account for that joint venture as if it were an associate in accordance with IAS 31.  This is intended to confirm the existing accounting treatment for police and fire joint boards in group accounts.  However, this is based on the boards being joint ventures and the logic of this basis has been challenged.  It is therefore likely that the Code will have to be amended.  However, it is expected that authorities will still be required to account for joint boards as associates, but the rationale for doing so may change. Further guidance will be provided in due course.

**2010/11 disclosures on new accounting standards**

Appendix C has been added in respect of disclosures required in the 2010/11 financial statements under paragraph 3.3.4.3 which requires an authority to disclose information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted.

The adoption of FRS 30 in 2011/12 is the only accounting change that requires disclosure in this regard. Authorities are required, where material, to disclose

- narrative explaining that heritage assets are to be recognised as a separate class of assets for the first time in 2011/12 in accordance with FRS 30
- the carrying amount of assets expected to be reclassified as heritage assets, and their classification in 2010/11
- the expected amount of any revaluation gains and losses to be recognised on reclassification
- the expected change in depreciation and impairment to be recognised.

Equivalent disclosures are also required in respect of community assets where authorities elect to measure them at valuation.

**Other changes**

Other changes include the following

- Paragraph 3.2.4.1 recommends that the proper officer in Scotland signs and dates the statement of accounts, stating that they give a true and fair view.
- The 2010/11 Code did not permit investment properties to be transferred to assets held for sale. The 2011/12 Code requires investment property that meets the criteria to be classified as held for sale to continue to be accounted for as investment property, but paragraph 4.4.2.7 has been amended to permit it to be reported separately as investment property held for sale.
- The surplus or deficit of trading operations which are not allocated back to services has been added to paragraph 3.4.2.43 as an item that should be included in the financing and investment income and expenditure line of the comprehensive income and expenditure statement.
- Section 3.7 requires a specific statement in the annual governance statement/statement on the system of internal financial control on whether the authority’s financial management arrangements conform with the governance requirements of the *Statement on the role of the chief financial officer in local government*. Where they do not conform, an explanation of how they deliver the same impact is required.

- The disclosure requirements for related party transactions at section 3.9 no longer apply to central government departments, government agencies, NHS bodies and other local authorities. Instead less detailed disclosures are required, such as the nature and amount of each individually significant transaction.

- The Code incorporates minor changes to the disclosures of the nature and extent of risks arising from financial instruments in section 7.4.3 of the Code. Changes include reduced disclosures in respect of financial assets that are neither past due nor impaired, and clarification of the disclosures required in respect of collateral and other credit enhancements obtained. Additional disclosures are also required by paragraph 7.4.2.2 where the level of concessionary loans granted by an authority is material, including details of nominal values, fair value adjustments, and loans repaid. The Code also clarifies that financial instrument disclosures are required in respect of leases and PFI/PPP arrangements.

- Paragraph 2.9.2.7 has been amended to confirm that irrecoverable VAT can be included in the cost of an asset, where appropriate.

The 2011/12 Code does not include any requirements in respect of the *Carbon reduction commitment* scheme because consideration of this issue has been deferred until the changes to the scheme are confirmed. It is intended that an update to the 2011/12 Code will incorporate the required changes in due course.

**Auditor action**

Auditors should confirm that their authorities are making the necessary arrangements to comply with the new requirements in the 2011/12 Code.

## 2010/11 Code guidance notes

The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued the *Code of practice on local authority accounting in the UK– guidance notes for practitioners - 2010/11 accounts* (the 2010/11 guidance notes) which are intended to assist in understanding how to apply the accounting requirements of the 2010/11 Code. The guidance notes provide background to the Code's requirements and include detailed illustrations, but are not prescriptive.

The guidance notes can be downloaded by inhouse audit providers from the TSU intranet. Licensing restrictions prevent it from being available from the extranet, but it can be ordered from the CIPFA shop.

They have been substantially re-written to reflect the changes to the 2010 Code and to clarify other matters. Changes from the 2009/10 guidance notes in respect of the following matters are particularly drawn to auditors' attention

- the movement in reserves statement
- the comprehensive income and expenditure statement
- disclosure notes on judgements and assumptions
- components of property, plant and equipment
- categorisation of leases
- assets held for sale.

**Movement in reserves statement**

Module 3 of the guidance notes provides guidance on the new financial statements required by the Code. Paragraph E1 explains that the movement in reserves statement should be a summary of the changes that have taken place in the bottom half of the balance sheet over the financial year. It analyses the increase or decrease in the net worth of the authority as a result of incurring expenses and generating income and in the fair value of its assets, as well as movements between reserves to increase or reduce the resources available to the authority according to statutory provisions.

Paragraph E3 considers the headings on the face of the statement as follows

- The balances as at the end of the current (and previous) reporting period should be taken from the figures for 31 March of the current (and preceding) year in the balance sheet, and should total to the net worth of the authority at those dates.

- The figures in the surplus or deficit on the provision of services line should generally only be for the general fund and the housing revenue account, and should be taken directly from the comprehensive income and expenditure statement.

- Figures should only appear in the other comprehensive income and expenditure line in respect of the unusable reserves (i.e. unrealised revaluation gains and actuarial gains/losses on retirement benefits) and should be taken directly from the comprehensive income and expenditure statement. The Code requires an analysis of this item, and paragraph E3 recommends that it be provided in a note.

- The line for adjustments between the accounting basis and the funding basis should consolidate all the adjustments needed to convert the surplus or deficit on the provision of services to the movement on the general fund balance for the year as defined by statutory provisions. This line should also be used to transfer amounts from the capital receipts reserve to the capital adjustment account when they have been applied.

Paragraph E4 refers to the Code's minimum classification of reserves for the statement and highlights that, while usable reserves should be analysed over the general fund, insurance fund, capital receipts reserve and capital fund etc, there should be a single heading to cover all the unusable reserves (e.g. revaluation reserve, pension reserve, capital adjustment account, financial instruments adjustment account and employee statutory adjustment account). Paragraph E5 highlights that the capital grants unapplied account has been omitted from the list of usable reserves in the Code.

Paragraph E10 makes the following recommendations for the design of the statement

- The requirements will almost certainly entail the statement being presented in a table with columns for each of the reserve categories, and rows for each of the movement types.
- The table could show the opening balances at the start of the preceding year, the prior year movements, the opening balances for the current year, the current year movements, and then the closing balances.
- The presentation of items on the face of the statement should be kept to the minimum required by the Code with all other information disclosed in the notes.

**Comprehensive income and expenditure statement**

Paragraph F4 makes the following points in respect of the presentation of items in the comprehensive income and expenditure statement

- The items that the Code lists as being included within the other operating expenditure line should also include gains or losses on the disposal of intangible assets.
- Gains and losses on trading accounts that cannot be accommodated by particular services within the service expenditure analysis should be included in the financing and investment income and expenditure line.
- Capital grants and contributions should be credited to the taxation and non-specific grant income line, even where they are service-specific, except where capital grant is passed on to other parties in which case it is credited to the service to match the spend.

**Disclosure notes on judgements and assumptions**

Paragraph I9 covers the Code's requirement to disclose in the notes the judgements that management has made in applying the accounting policies that have the most significant effect on the amounts recognised in the financial statements. It gives a number of examples of the judgements that might be disclosed including whether

- a lease is an operating or finance lease, and whether contractual arrangements have the substance of a lease
- a public/private partnership is a service concession
- land and buildings owned by the authority are investment properties
- the substance of a relationship between the authority and another entity indicates that the entity is controlled by the authority
- the authority's exposure to possible losses is to be accounted for as a provision or contingent liability.

Paragraph I14 covers the Code's requirement to disclose the assumptions that the authority has made about the future and other major sources of estimation uncertainty. It gives a number of examples of the estimates that might be disclosed including

- assumptions used in the calculation of depreciation
- assumptions about future events affecting provisions
- principal actuarial assumptions used at the balance sheet date in respect of defined benefit pension plans
- assessments of the recoverable amounts of arrears and other debtors
- fair values for property, plant and equipment, and financial assets and financial liabilities, that are not based on recently observed market prices.

**Property, plant and equipment - components**

Paragraphs D17 to D22 of Module 4 consider the transitional provisions for the Code's requirements in respect of depreciating significant components of assets. They highlight that there is little practical difference between the Code's requirements for componentisation for depreciation purposes from 1 April 2010 and the policies that authorities should have applied under the SORP.

The exemption from retrospective application should only affect an authority that did not separate major components before 1 April 2010. If that is the case, the Code's implementation provisions would potentially lock in a material misstatement in depreciation calculations that will be carried forward until the assets are enhanced or revalued. Authorities in these circumstances will need to take care in setting out their accounting policies and drafting notes to the accounts so that readers can understand the effect of the

Code's prospective provisions for component accounting. The guidance notes make the following suggestions

- The accounting policies should state the extent to which assets have components that are significant in relation to the total cost of the asset that have yet to be separated and describe the impact this has on the total depreciation charged in the year.

- Wherever useful lives and depreciation charges are discussed in the notes to the accounts, contextual material might need to be added to confirm, for example, that significant components are currently being assigned the useful life of the overall asset rather than one appropriate to their actual expected useful life, and (where practicable) to estimate the financial effect of the prospective policy.

- As the extent of componentisation grows with revaluations and component replacement in relation to assets held at 1 April 2010, this will constitute a change in accounting policy for those assets that (if material) will need to be presented and disclosed effectively.

**Leases**

Paragraph F10 sets out three further indicators which, if the analysis is not clear after considering the indicators in the Code, could also lead to a lease being classified as a finance lease. The indicators are the same as those added to the 2011/12 Code (see article on 2011/12 Code).

Paragraphs F116 to F119 consider the Code's requirements, derived from *IFRIC 4 Determining whether an arrangement contains a lease*, to identify arrangements which involve the provision of services using specific underlying assets which can be considered as containing a lease for those assets. They highlight that arrangements within the scope of IFRIC 4 may also fall within the scope of *IFRIC 12 Service concessions*, which should be applied instead, and therefore relatively few arrangements may fall to be accounted for under IFRIC 4. Those most likely to require an IFRIC 4 treatment will be arrangements where assets have residual values but the authority has no substantial interest in them.

**Assets held for sale**

Paragraph M4 discusses meeting the criteria set by the Code for an asset to be categorised as held for sale. It advises that

- an authority should have the intention and ability to sell the asset in its present condition. If a property needs repairs carried out before it can be sold, or if a sale is dependent on planning permission being obtained, it cannot be classified as held for sale until those issues have been addressed.

- in order for the sale to meet the requirement of being ‘highly probable’, it must be significantly more likely than probable

- any required approval by members must be obtained before an authority’s management can be considered committed to a plan to sell an asset

- initiating an active programme to locate a buyer and complete the plan requires those who might be interested in purchasing the property being made aware that it is for sale

- actively marketing an asset for sale entails more than just making it known that an asset is for sale; it requires positive efforts to sell by an authority. However, the notes offer the view that where it is not necessary to carry out active marketing (e.g. because the authority is able to identify prospective purchasers willing to pay a reasonable price without marketing or because a buyer initiates the transaction) this criterion should be treated as ‘not applicable’ rather than failed.

- where a plan to sell an asset is unrealistic or has significant omissions, it should not be classified as held for sale.

Where one or more of the above criteria are not met, the Code requires the assets to continue to be accounted for as property, plant and equipment and therefore valued at existing use value. The 2010/11 Code does not define the existing use value of surplus assets, but paragraph M15 recommends that they should be valued on the basis of their use before they were determined to be surplus (which is consistent with a change to the 2011/12 Code – see article on 2011/12 Code).

**Auditor action**

Auditors may find it useful to refer to the guidance notes when checking authorities’ compliance with the requirements of the 2010/11 Code.

## 2010/11 transition guidance

CIPFA has issued guidance notes on the restatement of 2009/10 information onto an IFRS basis as part of the transition to the 2010/11 Code. The following paragraphs draw auditors’ attention to particular points highlighted in the guidance notes.

**2.3 Government and non-government grants**

The requirement in the 2010/11 Code for grants and contributions for capital purposes, and donated assets, to be recognised immediately in the comprehensive income and expenditure statement (unless any conditions have not been met) is a change of accounting policy. This requires authorities to present restated comparative balance sheets as at 1 April 2009 and 31 March 2010, and to present a comparative comprehensive income and expenditure statement for 2009/10.

When restating the opening balance sheet, any balances on the government grants deferred account should be transferred to the capital adjustment account. Grants and contributions unapplied at 1 April 2009 require to be reviewed to establish whether there are any conditions as this determine the appropriate treatment as follows

- Where there are no conditions, the grant or contribution should be transferred to the capital grants unapplied account.
- Where a condition has yet to be satisfied, the grant or contribution requires to be transferred to capital grants receipts in advance.

When restating the 2009/10 comparative figures, grants and contributions received and applied during 2009/10 should be transferred from the government grants deferred account to the comprehensive income and expenditure statement and, via the movement in reserves statement, to the capital adjustment account. The guidance also covers a number of other possible scenarios, including grants and contributions received in previous years but applied during 2009/10, those received in 2009/10 with conditions outstanding at 31 March 2010, and those received in previous years where conditions were satisfied in 2009/10.

**4.1 Property, plant and equipment**

Adjustments may be needed where a revaluation loss on property, plant and equipment had been charged to the income and expenditure account and a subsequent revaluation gain on the same asset had been recognised in the revaluation reserve. The Code requires the gain to reverse the loss in the income and expenditure account, and then be transferred to the capital adjustment account

- The opening balance sheet would need to be restated by debiting the revaluation reserve and crediting the capital adjustment account.
- Comparative figures would have to be restated by debiting the revaluation reserve and crediting the comprehensive income and expenditure statement, and debiting the general fund and crediting the capital adjustment account.

**4.2 Lease and lease type arrangements**

The notes provide the following guidance for authorities reviewing their lease arrangements to determine whether or not leases need to be reclassified

- Where the authority is lessee and an operating lease is reclassified as a finance lease, an asset and a liability require to be recognised. Payments made since the inception of the lease require to be apportioned between the finance charge and the repayment of the liability. Depreciation needs to be charged from the commencement of the lease, and the general fund requires to be charged with the repayment of the liability.

- Where a finance lease is reclassified as an operating lease, the asset and liability will need to be derecognised, and any repayment of the liability requires to be adjusted.

- Where the authority is lessor and an operating lease is reclassified as a finance lease, the asset requires to be derecognised and a long-term debtor recognised. For each lease, authorities need to separate the lease income into a finance element and a repayment of principal element, with the repayment being applied to reduce the balance on the long-term debtor; a transfer from the general fund to the capital receipts reserve is required

- Where a finance lease is reclassified as an operating lease, the long-term debtor requires to be derecognised and the asset that would have been derecognised at the commencement of the finance lease requires to be reinstated. The balance on the fixed asset account requires to be adjusted for the depreciation chargeable between the time the asset was originally derecognised and the time it is reinstated, and the asset may also need to be revalued.

**4.4 Investment property**

Authorities are required to review their assets as at 1 April 2009 to identify those that meet the definition of an investment property. Assets classified as investment property under the SORP which do not meet the definition of an investment property under the Code should be reclassified as property, plant and equipment. Also, the Code requires changes in the fair value of investment properties to be recognised in the comprehensive income and expenditure statement and reversed using the capital adjustment account (the SORP required recognition in the revaluation reserve). This means that

- when restating the opening balance sheet, authorities should transfer any balances on the revaluation reserve in respect of investment property as at 1 April 2009 to the capital adjustment account

- any loss on revaluation at 1 April 2009 in excess of the balance on the revaluation reserve for an asset reclassified as property, plant and equipment under the Code should be transferred to the capital adjustment account

- when restating comparative figures for investment property, any revaluation during 2009/10 effected through the revaluation reserve will need to be reversed and recognised in line with the Code.

**4.9 Non-current assets held for sale and discontinued operations**

The opening balance sheet and 2009/10 comparatives require to be restated for assets that meet the criteria to be classified as held for sale. From the date the criteria are met, authorities are required to reverse any depreciation charged and reinstate the carrying amount where this amount is lower than fair value less costs to sell.

In the event that the criteria have not been met, authorities are required to reclassify the assets, and adjust the carrying amount of the asset. The following circumstances may apply

- Assets classified as surplus assets under the SORP may be reclassified as investment property under the Code. This may be the case for assets which do not meet the definition of a held for sale asset under the Code because, rather than actively marketing the asset, the authority is waiting for the property market to recover.
- Assets classified as surplus assets under the SORP also classified as surplus assets within property, plant and equipment under the Code. This will arise where an asset that was classified as a surplus asset does not meet the criteria to be classified as either held for sale or as an investment property under the Code e.g. where the asset is no longer used for service delivery but the authority has not, at the balance sheet date, decided whether to sell the asset or develop it. The asset requires to be valued at existing use rather than market value and the guidance recommends that the last use in providing services be used for this purpose.

### 6.2 Benefits payable during employment

The guidance states that HR or payroll systems should be capable of providing evidence as to the scale of any possible accrual for short term compensated absences which have accumulated but are untaken at the balance sheet date.

Where considered to be material, the restated opening balance sheet requires to recognise a provision for the amount by which the expenditure which would have been recognised had the Code always been in force exceeds the expenditure that was actually recognised in the accounts, with the double entry being to debit the general fund. This provision is then reversed in the 2009/10 accounts as the leave is taken, and replaced with an accrual for accumulated absences at 31 March 2010. Statutory guidance requires amounts charged to the general fund to be transferred to the employee statutory adjustment account.

The amount of the accrual for non-teaching staff should be calculated by multiplying the number of days to be accrued by the appropriate proportion of the annual salary

- Where the employee's leave year is aligned with the financial year, the accrual will be based on any leave carried forward at the end of the leave year. Where the employee's leave year is not aligned with the financial year, the leave earned by the employee to 31 March will need to be calculated and compared with the leave taken by 31 March to establish whether leave is owed to or by the employee.
- Contracts of employment specify the rate at which leave is paid; this is usually 1/261 of the annual salary per day.
- The cost should reflect not just salary but also employers' national insurance and pension contributions. Pay awards and increments that increase the salary in the following year, and any leave that may be lost, should also be taken into account.

The accrual required for teachers should be based on the difference between the number of days earned and the number of days holiday in the school year up to 31 March. Authorities therefore need to

- identify the number of term days between 1 September and 31 March
- multiply this figure by the rate at which leave is earned (0.3385 days for each day worked)
- compare this figure with the number of days holiday between 1 September and 31 March.

It is likely that authorities will need to conduct a sample check to establish the level of accrual required. Samples need to be representative of all groups of staff, and the size depends on issues such as the amount of expenditure and the expected level of leave.

**Auditor action**

Auditors may find it useful to refer to the guidance notes when checking authorities' restatement of 2009/10 information.

# Auditing developments

The document referred to in the following article can be obtained by using the hyperlink, and is available to auditors on the TSU intranet/extranet.

## Draft statement on role of head of internal audit

CIPFA has issued *The role of the head of internal audit in local government – draft* which is a draft statement that sets out the role of the head of internal audit (HIA) in local government. The draft statement builds on the statement on the role of HIA in the public services, and sets out the principles that define the core activities and behaviours that belong to the role of the HIA in local government. It states that this post plays a critical role in delivering the authority's strategic objectives by

- championing best practice in governance, objectively assessing the adequacy of governance and management of existing risks, commenting on responses to emerging risks and proposed developments
- giving an objective and evidence-based opinion on all aspects of governance, risk management and internal control.

To perform this role, the HIA must

- be a senior manager with regular and open engagement across the authority, particularly with the leadership team and with the audit committee
- lead and direct an internal audit service that is resourced to be fit for purpose
- be professionally qualified and suitably experienced.

For each principle, the statement sets out the governance arrangements required within an authority to ensure that HIAs are able to operate effectively and perform their core duties. The statement also sets out the core responsibilities of the HIA.

CIPFA recommends that authorities should use the statement as the framework to assess their existing arrangements, and that they should report publically on compliance to demonstrate their commitment to good practice. CIPFA also proposes that organisations should report publicly where their arrangements do not conform with the compliance framework in the statement, explaining the reason for this, and how they achieve the same impact.

Comments were required by 19 January 2011.

## Corporate governance developments

The document referred to in the following article can be obtained by using the hyperlink, and is available to auditors on the TSU intranet/extranet.

### Revised councillors' code of conduct

The Scottish Government has issued a revised *Councillors' code of conduct* that sets out the conduct required by local authority councillors. The code is a comprehensive statement of the principles and rules of conduct for councillors when performing their duties. The changes in this revised edition arise from a limited review of the code which was undertaken to

- address the implications for the code of the legislative reform of the Scottish planning system which came into effect during 2009
- review those areas of the code which would benefit from clarification or reconsideration.

The amendments are largely of a technical nature intended to bring the code up to date and to make it more easily understood. The majority of the amendments are in section 5 on the declaration of interests and section 7 on taking decisions on individual applications.

## Other developments

The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to auditors on the TSU intranet/extranet.

# Remuneration reports

## New requirement from 2010/11

*The Local Authority Accounts (Scotland) Amendment Regulations 2011* have been issued to require a local authority to prepare a remuneration report as part of its annual accounts from 2010/11. The regulations also include a schedule setting out the information that such a report should contain. The report is required to show the remuneration for each relevant person under a number of specified categories.

A relevant person is defined as

- a senior councillor, which means a Leader of the Council, a Civic Head or a Senior Councillor, as defined in *The Local Governance (Scotland) Act 2004 (Remuneration) Regulations 2007*
- a senior employee, which means any local authority employee who has power to direct or control the major activities of the authority, who holds a post that is politically restricted, or whose annual remuneration is £150,000 or more
- a senior police officer, which means a member of a police force who is a chief constable, a deputy chief constable or an assistant police constable, and also any other member whose annual remuneration is £150,000 or more
- the chief executive of a subsidiary, any councillor to which that body paid remuneration, and any director or employee of the body whose remuneration was £150,000 or more.

The total amounts of remuneration should be shown before tax and other deductions, and with comparatives, under each of the following categories

- salary, fees or allowances
- bonuses
- expenses allowance chargeable to income tax
- compensation for loss of employment
- non-cash benefits, with a footnote describing the nature of any such benefits
- any other payments received, other than pension payments.

The remuneration report should also show, in tabular form, for each relevant person the value of pension rights held and acquired by that person.

- Where the rights are to defined benefits, the information to be provided is: the value of the person's accrued pension benefits under the scheme as at 31 March; the difference between that value and the equivalent value as at the previous 31 March; and the amount of any pension contributions by the local authority or subsidiary.

- Where the rights involve a money purchase scheme, the information to be provided is the amount of any pension contributions by the local authority or subsidiary.

Remuneration reports are also required to

- provide details of the authority's remuneration policy for senior employees and senior councillors, and details of any role the authority has in determining the remuneration policy for any subsidiary
- describe the role, and state the membership of, the committee that deals with remuneration arrangements or, where there is no such committee, state how remuneration arrangements are managed within the authority
- give the number of employees or police officers whose remuneration fell into each bracket of a scale in multiples of £5,000, starting with £50,000, along with comparatives
- give the name of any subsidiary, together with the name of the chief executive, the name of each councillor to which that body paid remuneration, and the post title and name of each director or employee whose annual remuneration was £150,000 or more.

Where an authority has contractually bound itself, prior to these regulations being issued, to not disclose publicly the terms on which it remunerates a person, it is not required to disclose remuneration details for any year prior to 2010/11.

Auditors should confirm that their authorities are making the necessary preparations to comply with the requirement for a remuneration report from 2010/11. Auditors should also be planning to meet the requirement to audit the remuneration report. Further guidance in this regard will be provided by the TSU in due course.

## Feedback on consultation

The Scottish Government has issued a letter which provides feedback on the consultation on the requirement to prepare a remuneration report. It highlights the following key changes to matters proposed in the consultation (see TB 2010/3 – page 27)

- Pension contributions has been dropped from the proposed definition of remuneration. The requirement to disclose pension contribution information still remains but it now forms part of the pension benefits disclosure.
- References in the consultation to 'salary' have been replaced with 'remuneration' in respect of disclosures of £150,000 or more.

The following proposals contained in the consultation paper, that have not been included in the regulations, will be the subject of further consideration

- disclosures in regard to cash equivalent transfer values

- specific categories of staff to be used in the disclosure note for the remuneration of all staff earning over £50,000
- the publication of copies of the accounts of local authority subsidiaries on a website
- the approval or signing of the remuneration report.

Non-statutory guidance is being drafted to assist authorities implement the requirements of the regulations.

# Pension funds

## Statutory accounting guidance from 2010/11

The Scottish Government has issued *Statutory guidance on accounting for local authority pension funds* from 2010/11. Local government pension fund accounts have to date formed part of the administering authority's own annual accounts, and these accounts have not been the subject of a separate audit opinion. However, the statutory guidance changes this approach.

A recent amendment to *The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008* (see TB 2010/3 – page 29) requires authorities to publish a pension fund annual report from 2010/11. The annual report is a publication separate from the authorities' own statutory accounts, and the regulations require it to include a fund account and net asset statement with supporting notes and disclosures prepared in accordance with proper practices. The statutory guidance clarifies that pension fund financial statements should be prepared in accordance with proper accounting practices set out in the local authority accounting Code. They are required to be treated as an additional abstract of accounts and will therefore continue to be subject to the arrangements as set out in sections 96 to 103J of the *Local Government (Scotland) Act 1973*, and any regulations issued under section 105 of the Act.

The pension fund financial statements will not be the subject of a separate audit appointment. However, the appointed auditor of each administering authority will be required to issue a separate audit opinion on the abstract relating to the pension fund.

The deadlines that apply to the pension fund accounts are the same as those for the main accounts of the local authority i.e. they must be prepared by 30 June. The audit deadline of 30 September also applies. However, for 2010/11, the following transitional arrangements apply

- The financial statement element of the pension fund annual report requires to be submitted for audit by 30 June 2011.
- The pension fund annual report, incorporating the financial statements, requires to be submitted to auditors by 30 September 2011.
- Auditors are required to complete the audit process by 30 November 2011.

Pension fund financial statements are no longer required to be included in the administering authorities' main accounts. Instead, the statutory guidance requires an authority to disclose in its accounts

- a note that the authority is an administering authority for the local government pension scheme
- the pension funds it is responsible for, including a general description of each fund and its membership
- the statutory requirements for the publication of a separate pension fund annual report, and the contents of that report
- how the pension fund annual report can be accessed or obtained.

Auditors should confirm that their authorities are making arrangements to comply with this guidance, and should ensure they comply with the audit requirements.

## Police

### Changes to carry forward limits

The percentage of unspent police funds that can be carried forward has been increased by *The Police Grant (Carry-forward Percentages) (Scotland) Order 2011*. The percentages have been increased from

- 3% to 4% of the total funding received for the annual limit
- 5% to 8% for the cumulative limit, above which consent from the Scottish Ministers is required.

The Order came into force on 21 March 2011 and therefore applies from 2010/11.

### Consultation on reform

The Scottish Government has issued *A consultation on the future of policing in Scotland* which sets out options for reforming police structures. The paper considers the following three options

- one police force for Scotland under the leadership of a single chief constable, which the paper favours
- a reduction to three or four large regional police forces, each led by a chief constable
- significantly enhanced collaboration between the existing eight forces.

Comments should be sent to policereform@scotland.gsi.gov.uk by 5 May 2011.

## Fire

### Consultation on reform

The Scottish Government has also issued *A consultation on the future of the fire and rescue service in Scotland* which sets out options for reforming the Scottish fire and rescue service.

The options are broadly the same as those set out for the police service, and similarly the paper favours the single service option.

Comments should be sent to firereform@scotland.gsi.gov.uk by 5 May 2011.

## Benefits

### 2010/11 HB COUNT modules

The Audit Commission has issued the *HB COUNT modules for 2010/11* which set out the Commission's approach to the audit of housing and council tax benefit (HB/CTB) subsidy claims. HB COUNT was designed by the Audit Commission but external auditors in Scotland also use the HB COUNT testing and reporting approach when certifying HB/CTB subsidy claims.

HB COUNT is set out in six modules which are updated and agreed with the DWP each year. The following have been issued

- Module 1 provides an overview of the approach and examples of qualification letters.
- Module 2 contains a checklist to help auditors confirm that the authority's system is using the correct benefit parameters to calculate benefit entitlement and for the authority to claim the correct amount of subsidy.
- Module 3 comprises workbooks to be completed for detailed testing, incorporating step-by-step guidance and a test result summary.

Module 4 is an analytical review tool and module 5 is a software diagnostic tool but these have not yet been issued. Module 6 relates only to England.

A key element of the HB COUNT approach involves taking a sample of 20 benefit cases chosen at random from the audit trails supporting each of the headline cells for rent rebates, rent allowances and council tax benefit on an authority's subsidy claim form. A sample case is defined by its case reference number, and all benefit transactions in the year against the case reference number require to be tested.

The testing required is set out in the Module 3 workbooks, which record whether each case selected passes or fails each test. Where testing identifies issues that can be resolved, amendments are agreed with the authority. If auditors are unable to conclude that the authority's claim can be amended to make it fairly stated, or they conclude an amendment is possible but the authority does not agree the proposed amendment, they will apply the 40+ testing approach. This entails testing a further 40 cases and reporting the results of all the tests in the auditor's covering letter. The DWP can then decide how the results of the testing affect the amount of subsidy payable to the authority, without further recourse to auditors.

It may be quicker and more cost effective for any 40+ testing to be carried out by the authority with the findings reviewed by the auditor, including an element of re-performance. If authorities do not wish to carry out the additional testing, auditors will do so and reflect this additional work in the audit fee.

# Legislation

The following items of legislation can be obtained by using the hyperlinks, and are available to auditors on the TSU intranet/extranet.

## Statutory instruments

### Local government

*The Local Authority Accounts (Scotland) Amendment Regulations 2011, SSI 64* come into force on 31 March 2011. See Other developments – Remuneration reports – New requirement from 2010/11.

*The Local Government Finance (Scotland) Order 2011, SSI 109* came into force on 28 January 2011 and determines the amount of the revenue support grant (RSG) payable, and non-domestic rate income to be distributed, to each local authority for 2011/12, and redetermines RSG payable for 2010/11.

### Council tax

*The Council Tax (Discounts) (Scotland) Amendment Order 2011, SSI 5* comes into effect on 1 April 2011 and makes changes to the definition of 'student' for the purposes of council tax discounts from 2011/12.

### Rating and valuation

*The Non-Domestic Rate (Scotland) (No. 2) Order 2010, SSI 457* comes into force on 1 April 2011 and prescribes that 42.6 pence is the rate to be levied for non-domestic rates for 2011/12.

### Police

*The Police Grant (Scotland) Order 2011, SSI 62* comes into force on 1 April 2011 and determines the amount of police grant to be paid in 2011/12.

*The Police Grant (Carry-forward Percentages) (Scotland) Order 2011, SSI 148* comes into force on 21 March 2011. See Other developments – Police – Changes to carry forward limits.

### Pensions

*The Teachers' Superannuation (Scotland) Amendment (No. 2) Regulations 2011, SSI 52* come into force from 1 April 2011 and amend the principal 2005 superannuation regulations in respect of the re-valuation of additional pension. The amendment makes provision for additional pension purchased before 1 April 2011 to continue to be re-valued by the RPI, and for additional pension purchased on or after that date to be re-valued in line with the rate set under the *Pensions (Increase) Act 1971*.

## Key circulars

The following circulars can be obtained by using the hyperlinks, and are available to auditors on the TSU intranet/extranet.

## Finance circulars

*Finance circular 14/2010 Local government finance settlement 2011/12* provides details of the updated, provisional total funding allocations for each council for 2011/12.

*Finance circular 15/2010 Non-domestic (business) rate poundage for 2011/12* sets the 2011/12 non domestic rates poundage rate at 42.6 pence.

*Finance circular 1/2011 Statutory guidance on accounting for local authority pension funds*. See Other developments – Pension funds – Statutory accounting guidance from 2010/11.

*Finance circular 2/2011 Local Government Finance (Scotland) Order 2011 – settlement for 2011/12* provides a summary of the figures contained in *The Local Government Finance (Scotland) Order 2011*, together with details of individual allocations of total revenue and capital support for 2010/11 and 2011/12.

*Finance circular 3/2011 The Non-domestic Rating (Payment of Interest)(Scotland) Regulations 1992 – interest rate for 2011/12* specifies an interest rate of 0% for calculating the interest due when repaying overpaid rates in respect of 2011/12.

*Finance circular 4/2011 Local government finance settlement for 2011/12 – amendment orders 2011* provides amended details of individual allocations of total revenue and capital support for 2010/11 and 2011/12.

# Benefits circulars

## Adjudications and operations

*HB/CTB circular A26/2010 Housing and council tax benefit: 2011 uprating* advises of housing benefits/council tax benefit (HB/CTB) uprating from April 2011. Key points include the following

- Many local authorities apply percentage increases to uprate income from other social security benefits. However, regulations do not provide for uprating a customer's social benefit by anything other than the correct amount, and authorities are required to satisfy themselves over the accuracy of their uprating method.
- Non-dependant deductions (NDD) will be increased over the next three years, and therefore accurate NDD evidence will be increasingly significant to relevant HB/CTB cases.
- The Pension, Disability and Carers Service calculation of income, capital and savings credit must be used for state pension credit, and authorities should not calculate the figures themselves.

# Section 102 reports

Under *section 102(1) of the Local Government (Scotland) Act 1973*, the Controller of Audit may report to the Accounts Commission on the accounts of local authorities or any matters arising from the accounts. The following report has been prepared since TB 2010/4 and can be obtained by using the hyperlink.

## The Highland Council: Caithness heat and power – follow-up report

This follow-up report is in response to the Account's Commission's direction for further investigations into The Highland Council's involvement in the *Caithness heat and power* project (see TB 2010/3 – page 35). The Controller concluded that there was a lack of a co-ordinated, corporate response to governance and ultimately the project, service users and council finances were left exposed.

However, the council has responded to the serious concerns raised and officers are implementing remedial action for which they are accountable to elected members. External auditors will assess the progress made and the effectiveness of revised arrangements as part of their planned audit work and will report in the usual way.

# Publications

The following publication can be obtained by using the hyperlinks.

# Audit Scotland

## An overview of local government in Scotland 2010

This publication *An overview of local government in Scotland 2010* draws on the local government audit work carried out in 2010 and other performance information published during the year. Key messages include the following

- The audited accounts for 2009/10 showed a relatively stable position, with the overall level of reserves similar to last year. Capital expenditure continued to increase and financing patterns are changing, with more borrowing and less funding from capital receipts and grants.
- Unmodified audit opinions were issued for all councils except Shetland Islands because the group accounts did not include a charitable trust. While the opinion on the accounts of Edinburgh City was unqualified, the auditor included an 'emphasis of matter' paragraph describing the significant uncertainty around the future of the project to introduce trams to Edinburgh.
- Some councils' group balance sheets show net liabilities, mainly due to increasing liabilities associated with police and fire pensions. However, all group accounts were prepared on a 'going concern' basis because pension liabilities will be funded as they fall due.
- 88% of significant trading operations (STOs) achieved their statutory requirement to break even over a rolling three-year period. The number of STOs is now around half that in 2004/05.

# Auditor action

The following is a summary of items in this chapter of the TB that recommend that auditors take certain actions

| Section | Action |
|---|---|
| TSU developments – Responses to enquiries – Pension funds | Auditors should strongly encourage their authorities to include a governance compliance statement in the pension fund annual report. |
| TSU developments – Responses to enquiries – Benefits | Auditors should ensure they have arrangements in place to comply with the requirements to be able to access the DWP's customer information system.<br>. |
| Accounting developments – 2011/12 Code | Auditors should confirm that their authorities are making the necessary arrangements to comply with the new requirements in the 2011/12 Code. |
| Accounting developments – 2010/11 Code guidance notes | Auditors may find it useful to refer to the guidance notes when checking authorities' compliance with the requirements of the 2010/11 Code. |

| | |
|---|---|
| Accounting developments – 2010/11 transition guidance | Auditors may find it useful to refer to the transition guidance notes when checking authorities' restatement of 2009/10 information. |
| Other developments – Remuneration reports – New requirement from 2010/11 | Auditors should confirm that their authorities are making the necessary preparations to comply with the requirement for a remuneration report from 2010/11. Auditors should also be planning to meet the requirement to audit the remuneration report. |
| Other developments – Pension funds – Statutory accounting guidance from 2010/11 | Auditors should confirm that their authorities are making arrangements to comply with the statutory guidance, and should ensure they comply with the audit requirements. |

# Health chapter

## Introduction

This chapter contains articles on health technical developments and guidance relevant to external auditors' responsibilities under their audit appointment to give an opinion on the financial statements.  It should be read by external auditors with appointments in the health sector.  Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors.  More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance and urgent issue notes).

The articles in this TB are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development.  In many cases, it may still be necessary for auditors to read the source material.  The documents referred to in the articles can be obtained by using the hyperlinks.  They are also available to auditors on the TSU intranet/extranet.

In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note the following articles in this chapter are of relevance to 2010/11 audits

- urgent issue notes on audit assurance on the application of pay policies
- 2010/11 accounts manual
- 2010/11 capital accounting manual
- guidance on depreciation
- 2010/11 statement of internal control guidance
- new manual for Caldicott Guardians
- guidance on conduct during the election
- efficiency framework
- review of application of pay policies
- on call arrangements
- framework on supplementary medical staff

- additional public holiday
- 2010/11 pharmacy remuneration arrangements
- Revised property transaction handbook.

There is also an article on the Scottish living wage.

# TSU developments

## Publications

The following have been published by the TSU since TB 2010/4 and are available to auditors on the TSU intranet/extranet. They can be sent to other TB recipients on request.

### Urgent issue note on audit assurance on application of pay policies

The TSU published *Urgent issue note 2011/1(H) Audit assurance on application of pay policies - staff earning over £100,000* to provide guidance to auditors on the requirement for health boards to undertake a detailed review of the application of their policies in approving adjustments to the pay of all staff earning over £100,000 (see Other developments - Pay modernisation and workforce planning - Review of application of pay policies).

### Updated urgent issue note on audit assurance on application of pay policies

The TSU published *Urgent issue note 2011/2(H) Audit assurance on application of pay policies - staff earning over £100,000 - update* to provide auditors with further guidance as a result of supplementary guidance issued by the Scottish Government Health Directorate (SGHD).

# Accounting developments

The documents referred to in the following articles are available to auditors on the TSU intranet/extranet.

## 2010/11 accounts manual

The SGHD has issued the *NHS boards accounts manual for directors' report and accounts* for 2010/11 which interprets the accounting guidance contained in the *Government financial reporting manual* (FReM) for the NHS in Scotland. There are relatively few changes to the manual following the significant changes due to the introduction of IFRS in 2009/10, but the main changes are summarised in the following paragraphs.

**Annual report**

There have been the following three changes to the required annual report disclosures

- Boards are required to disclose details of how they have met the requirements to publish the information on expenditure and other matters specified by the *Public Services Reform (Scotland) Act 2010*.
- The reference to the date of authorisation for issue has been amended to reflect the amended FReM requirement that this should not be disclosed on the title page of the financial statements.
- A requirement to disclose performance pay or bonuses separately from salaries in the remuneration report has been added.

**Statement of comprehensive net expenditure**

The operating cost statement has been replaced by a statement of comprehensive net expenditure. This includes the disclosure of other comprehensive expenditure including the net gain or loss on the revaluation of property, plant and equipment, intangibles and available for sale financial assets, which have been taken to the revaluation reserve.

The statement of resource outturn, which now forms part of the statement of comprehensive net expenditure, has been amended to reflect the split between core and non-core revenue allocations. Included within non-core revenue are capital grants, depreciation/amortisation, annually managed expenditure (AME) funded impairments, provisions and PFI revenue expenditure.

**Accounting policies**

Note 1 on accounting policies has been amended to reflect the removal of the cost of capital charge from 1 April 2010. This is a change in accounting policy and requires the restatement of prior year balances, including balances as at 1 April 2009.

Boards are also required to include within this note a statement on the key assumptions on asset lives where they have implemented a change in the basis of estimation for depreciated replacement cost properties in 2010/11 (see article on guidance on depreciation).

**Impairment**

The guidance on note 3 on other operating costs has been amended to reflect that impairment losses arising from a clear consumption of economic benefit should be taken to the statement of comprehensive net expenditure, even if there is a balance on the revaluation reserve. The balance on any revaluation reserve to which the impairment would have been charged under IAS 36 should be transferred to the general fund.

### Capital resource limit

The note 9 analysis of capital expenditure has been amended to introduce a non-core capital resource limit (CRL) which should only relate to capital expenditure on PFI schemes.

As boards are now allocated non-core revenue for capital grants, the charge against the CRL reported on note 9 will be zero for 2010/11. Similarly, the profit or loss on disposal of non-current assets will be zero, as this now scores as revenue.

### Provisions

Note 17 has been amended to reflect the changed treatment of provisions. Until 2009/10, all movements on provisions were charged against the revenue resource limit (RRL). From 2010/11, the creation of provisions, and any movements relating to them, are treated as AME and charged against a separate non-core RRL. However, the cash payment made against the provision will be charged to the core RRL.

All provisions created before 31 March 2010 will have been charged to the prior years' RRL. However, any movements on these provisions will now score in AME and be charged against the non-core RRL.

### Exit packages

A new note 32 has been added to provide summary information on the use of exit packages in the year. However, the covering letter advises that recent guidance from HM Treasury may require an amendment to this requirement.

### Auditor action

Auditors should confirm that their boards are aware of this guidance and consider the implications for the audit of the 2010/11 annual accounts.

## 2010/11 capital accounting manual

The SGHD has issued the *Capital accounting manual* for 2010/11 which interprets the accounting guidance contained in the FReM on capital accounting issues in the NHS. There are relatively few changes to the manual from the previous version, but the two main changes are references to the

- cost of capital charge being removed to reflect the discontinuation of capital charging
- non-profit distributing model and the Hub initiative being added to the guidance on PFI/PPP accounting.

Auditors should confirm that their boards are aware of this guidance and consider the implications for the audit of the 2010/11 annual accounts.

## Guidance on depreciation

The SGHD has issued supplementary guidance on depreciating buildings valued on a depreciated replacement cost basis from 2010/11. The methodology outlined in the guidance assumes that each major building, external works and the land is significant in relation to the total cost of the hospital site and therefore represents a component.

The key change to the current methodology is that within the building 'component' the depreciable amount should be calculated by splitting the elements into two categories as follows

- Sub-components which are considered to be significant to the building should be depreciated over the remaining useful life of that sub-component. Replacements should be charged as capital expenditure.
- For shorter life elements, the new methodology takes account of the impact of regular maintenance and preservation expenditure which makes the useful lives more closely aligned with the overall life of the building; they should therefore be depreciated over the life of the building. Any future expenditure on these elements should be classed as revenue expenditure and boards are required to ensure that they have appropriate repair and maintenance budgets for these elements.

The change should be accounted for as a change in estimate in accordance with *IAS 8 Accounting policies, changes in accounting estimates and errors.*

Funding is currently provided in non-core revenue for depreciation. Where there is a revision to the depreciation charge, the difference will be transferred from non-core revenue to core revenue, except for PFI schemes which will be managed centrally. Boards are required to notify the SGHD of any changes to estimates as a result of the amended methodology.

Auditors should confirm that their boards are aware of this guidance and, where appropriate, are taking steps to implement the methodology.

# Governance developments

The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to auditors on the TSU intranet/extranet.

# Corporate governance

## 2010/11 statement of internal control guidance

The SGHD has issued a letter to provide boards with updated guidance to be used in the preparation of the statement of internal control (SIC) for the 2010/11 annual accounts.  The SIC is an integral part of the annual reporting process and the annual financial statements.  It needs to be approved by each board's chief executive, endorsed by its audit committee and passed to the external auditors for review.

The Corporate Governance and Audit Group has prepared this guidance to assist boards identify sources of assurance and evidence of compliance to be considered when preparing the SIC.  The format of the SIC and the extant guidance on governance issues are set out in annexes to the letter.

Boards are required to apply the guidance fully and consistently to enable the Scottish Government Health and Wellbeing Audit Committee to form an opinion on internal control across NHSScotland.  The Chair of boards' audit committees are also required to send a letter to the chief accountable officer of NHSScotland to advise of any governance issues that should be brought to their attention.  As a minimum, this letter should include the issues disclosed in the SIC. The guidance covers

- the review of the effectiveness of the internal control framework by the chief executive.  At a minimum, this should cover an assessment of the effectiveness of the internal control and risk management arrangements covering overall good governance

- sources of assurance including the work of internal and external audit

- the role of the audit committee for reviewing the disclosures included in the SIC.  The audit committee should receive the information provided to the chief executive in support of the SIC and should also consider in advance the other information it wishes to receive.  It may wish to receive from external auditors a description of their processes and judgements in the review of the reliance that can be placed on the work of internal audit

- the required disclosures.  The SIC should provide a balanced assessment of the significant risks and the effectiveness of the system of internal control in managing those risks.  All significant control failings or weaknesses identified must be individually disclosed in the relevant section, including their impact and the actions being taken to rectify them.

The guidance highlights that boards should have in place a framework that provides overt assurance on best value for 2010/11 which should be based on the secondary best value guidance issued to accountable officers and the developments within *Better health, better care*.

It also states that, in line with the Scottish Governments finance guidance note, significant deviations from the *Government internal audit standards* should be considered by health bodies for inclusion in the SIC.

Auditors should confirm that their boards are aware of this guidance and that the disclosures in the SIC are not inconsistent with information of which they are aware.

## New manual for Caldicott Guardians

The SGHD has issued a *Foundation manual for NHSScotland Caldicott Guardians* to set out the role of the Caldicott Guardian within an organisational confidentiality function and broader information governance arrangements. A Caldicott Guardian requires to be appointed by health boards to oversee the arrangements for the use and sharing of patient identifiable information.

The Guardian should be a senior health professional and existing member of the board to ensure they have the seniority and authority to influence policy and strategic planning. It is their responsibility to facilitate understanding and awareness of the organisational and individual requirement to maintain the confidentiality of patient-identifiable information. They have a strategic role to ensure that appropriate arrangements are in place covering strategy and governance, confidentiality and data protection expertise, and information processing and sharing.

The Guardian also plays a key operational role to actively support work that facilitates and enables information sharing, and advises on options for lawful and ethical processing of information as required.

## Guidance on conduct during election

The SGHD has issued a letter providing guidance on the conduct of business during the Scottish Parliament election. In carrying out their day to day work, boards are required to do nothing that could reasonably be construed as politically motivated. Care should be taken over publications and announcements of decisions made by boards to avoid political controversy. Existing advertising campaigns should be closed and there should be a general presumption against undertaking new campaigns unless agreement has been reached in advance with the SGHD. Boards may proceed within the terms of any legally binding commitments, but no further decisions should be made, or actions taken, which are of a continuously binding or long-term character without seeking SGHD advice.

Employees are required to avoid doing anything in their corporate day to day activities that could be regarded as taking a political stance. They are free to engage in public debate or comment during the election period, but should not use their official premises or equipment, and should not make comments based on information not generally available to the public. It must be clearly stated that the views expressed are those of the individual and not of any board. Boards are required to issue guidance to all non-executive members and staff.

There should be even-handedness in meeting requests for factual information and such requests should be handled in accordance with the *Standards of Conduct, Accountability and Openness of NHSScotland* and the *Freedom of Information (Scotland) Act 2002*.

A full-time employee who is elected to the Scottish Parliament would be expected to resign. Chairs and other non-executive members are disqualified from being a member of the Scottish Parliament, and therefore members who wish to stand for election are required to resign prior to their nomination forms being lodged.

# Other developments

The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to auditors on the TSU intranet/extranet.

## National agenda/direction

### Efficiency framework

NHSScotland has issued the *NHS efficiency and productivity: Framework* which identifies priority areas to improve quality and efficiency during the 2011/15 spending review period. Boards achieved the required 2% year-on-year minimum efficiency savings from 2007/08 to 2009/10. However, although the NHSScotland budget has been protected from cuts, inflationary pressures arising from demographic changes, drugs and staff costs mean that boards will need to make a minimum of 3% efficiency savings to break even in 2010/11. The target has been increased from £478m to £515m with territorial boards planning to save an average of 3.22%.

Seven cost reduction workstreams (e.g. prescribing, procurement, service redesign and innovation, and workforce productivity) will identify where savings and quality improvements could be made. The first stage of implementation will involve scoping each workstream to identify and prioritise cost reductions from the list of opportunities highlighted in the framework and the resources required to achieve the desired results. The local delivery plan process will allow boards and the Scottish Government to monitor progress.

The governance of the framework will continue to be overseen by the Efficiency and Productivity Strategic Oversight Group, who will refresh it annually. The Quality and Efficiency Support Team, previously the Improvement and Support Team, will provide support and challenge.

## Pay modernisation and workforce planning

### Review of application of pay policies

The Cabinet Secretary for Health and Wellbeing has issued a letter requesting boards to undertake a review of all staff earning over £100,000 to ensure that pay policies have been properly applied. The letter requires external auditors to provide specific reassurance that each board has been fully compliant with national policies and guidance in approving adjustments to the pay of these staff. Boards are required to provide the results of the review, and an explanation for any variations from the national policies and guidance, by 31 March 2011.

The SGHD has issued two letters to give boards guidance on the review. Key points are as follows

- The review should cover the four years from 2007/08 to 2010/11.
- Salary and allowances should include basic salary and any additional allowances such as distinction awards, discretionary points, management fees etc, but should not include employer on-costs.
- The first letter states that boards are required to consider all staff whose combined salary and allowances take them over the £100,000 threshold. However, the second letter clarifies this requirement by stating that boards should undertake an initial review of their processes to ensure that pay policies for staff earning over £100,000 are in compliance with national policies. They should prepare a list of all staff earning over £100,000 and select a sample to check, for compliance with policies and circulars, back to individual files. The letter requests that boards confirm with their auditor that the methodology and sample size selected by the board will meet audit requirements.
- External audit assurance should be provided by examining a representative sample.

Auditors should confirm that their boards are aware of this guidance, are taking steps to undertake the review and that their proposed sample size and methodology will meet external audit requirements.

## On call arrangements

PCS(AFC)(2011)2 informs boards of the extension of arrangements under *Agenda for change*, whereby staff are able to retain their previous on-call arrangements on a protected basis pending the agreement of harmonised provisions.

This protection was due to come to an end on 31 March 2011. However, a working group has only recently been set up to negotiate future arrangements on a Scotland-wide basis. It has therefore been agreed that the current arrangements should be extended beyond 31 March 2011, until further clarification is issued, to allow these negotiations to be concluded within 2011/12.

PCS(AFC)(2011)1 informs boards that on-call allowance and payment for call outs to staff on the *Agenda for change* or protected on-call arrangements should be included in pay during sick leave. The guidance applies from 1 October 2010, but boards may apply it retrospectively from 1 October 2004.

## Framework on supplementary medical staff

The SGHD has issued a best practice framework on using supplementary medical staff with *CEL(2011)4*. The guidance sets out the measures boards should take to reduce the need for supplementary staff, including agency staff, and, where their use is unavoidable, to ensure a high quality and affordable supply. Boards are required to determine their own local processes using the parameters set out in this guidance.

The guidance includes proposals on the establishment of a medical bank at board or regional level, supported by a national database. A large board will host the database and the contracts of bank and medical staff who are not substantively employed by NHSScotland. This is intended to ensure that all doctors undertaking medical bank work have access to appraisal and revalidation, induction and staff training. Until the national system is available, boards will hold details locally.

All eligible doctors will be able to sign up to work in medical staff banks. One of the key groups is doctors in training, and targeted work is being undertaken with NHS Education for Scotland to boost the supply. Processes and standards for internal and external recruitment will be set out nationally, and boards are required to ensure appropriate induction for all supplementary medical staff. Doctors working in temporary posts must be able to demonstrate that they are up to date with current medical practice. Paid study will be facilitated to enable bank-only staff to meet the requirements for the post.

## Additional public holiday

*PCS(DD)(2011)1* advises that there will be an additional public holiday for all employed doctors and dentists to celebrate the royal wedding on Friday 29 April 2011. *PCS(AFC)(2011)3* confirms that the public holiday will also apply to staff covered by *Agenda for change*, including board medical directors and the executive and senior management cohorts.

The additional public holiday will be applied in line with existing terms and conditions of service including enhanced payment rates where staff are required to work during the public holiday. Boards will be expected to meet any additional costs from existing funding.

## 2010/11 pharmacy remuneration arrangements

*PCA(P)(2011)3* advises boards of chronic medication service implementation payments (CIP) payable to community pharmacy contractors from 1 January 2011. Contractors joining the list, or taking over an existing contractor, from that date will be entitled to claim fixed payments totalling £750 in the following two parts

- an aspiration payment of £500 per contractor paid April 2011
- a final settlement payment of £250 per contractor paid May 2011.

For contractors who have taken over a previous contractor, the aspiration payment will include a variable banding payment based on average monthly dispensing volume for the previous contractor. If the contractor achieves the notional registration figure in the assigned band or higher, they will receive the payment for that band less the aspiration banding payment. If the contractor does not achieve the notional registration figure in his assigned band, no further payment will be made. Payments will be made in April and May 2011, based on February and March dispensing.

### The Scottish living wage

*PCS(AFC)(2011)4* advises of the introduction of the *Scottish living wage* to NHSScotland from 1 April 2011. The *Scottish living wage*, as announced in the Scottish Government's *Public sector pay policy for staff pay remits 2011/12*, is currently set at £7.15 per hour.

Staff on point 1 of the *Agenda for change* pay matrix, which affects pay bands 1 and 2, currently earn less than £7.15 per hour. The circular therefore advises that all staff on point 1 should be moved to point 2, and requires boards to stop using point 1.

## Capital

### Revised property transaction handbook

The SGHD has issued a revised edition of the *NHSScotland property transactions handbook* with *CEL(2011)8*. The handbook is intended to ensure that property is bought, sold and leased at a price, and on other conditions, which are the best obtainable. It covers the management of property transactions and provides guidance on the procedures to be followed in complying with the mandatory requirements, such as option appraisal and post-transaction monitoring. The mandatory requirements and supporting guidance in this edition are, in the main, unchanged.

Boards are required to follow the terms set out in the handbook and are responsible for ensuring that all property transactions obtain the best outcome, having regard to the mandatory requirements. Where specific procedures are not laid down, boards are required to act in accordance with best professional advice.

# Legislation

The following items of legislation can be obtained by using the hyperlinks, and are available to auditors on the TSU intranet/extranet.

## Statutory instruments

### National health service

*The National Health Service (Pharmaceutical Services)(Scotland) Amendment Regulations 2011* *SSI 32* come into force on 1 April 2011 and make various amendments to the principal regulations. The amendments

- require an applicant to submit detailed information to the board, including the outcome of a consultation on the application
- require boards to notify certain dispensing doctors of an application, and make changes to the way in which an appeal against the decision of the board is dealt with
- change the constitution and operation of the National Appeal Panel to reduce the number of panel members from nine to three and require the chair of the panel to be legally qualified.

*The NHS Quality Improvement Scotland (Dissolution) Order 2011* *SSI 36* comes into force on 1 April 2011 and dissolves NHS Quality Improvement Scotland from that date.

*The National Health Service (Superannuation Scheme and Pension Scheme) (Scotland) Amendment Regulations 2011* *SSI 53* come into force on 1 April 2011 and amend the principal 1995 regulations in respect of the option to purchase increases in a member's pension. The basis on which the calculation of the increase relies is changing from the RPI to the 'prices index' which is linked to the *Pensions (Increases) Act 1971*.

*The National Health Service (Free Prescriptions and Charges for Drugs and Appliances) (Scotland) Regulations 2011* *SSI 55* come into force on 1 April 2011 and provide for the revocation of the 2008 regulations thereby abolishing charges payable on Scottish and Welsh prescription forms which are presented to pharmacists in Scotland. Any person who pays a charge, who is entitled to be exempt, can claim a refund. Charges payable in relation to English prescription forms have been retained.

*The Personal Injuries (NHS Charges) (Amounts) (Scotland) Amendment Regulations* *SSI 71* come into force on 1 April 2011 and amend the principal regulations to increase the charges which a person who pays compensation to an injured person must pay for NHS treatment. The increases are as follows

- The charge for each use of ambulance services is increased from £177 to £181.
- Where the injured person receives NHS treatment but is not admitted to hospital, the charge is increased from £585 to £600.
- The daily charge for in-patient treatment is increased from £719 to £737.
- The maximum charge is increased from £42,999 to £44,056.

*The National Health Service Superannuation Scheme (Scotland) Regulations 2011* *SSI 117* come into force on 1 April 2011 and consolidate the provisions of the 1995 superannuation regulations.

*The National Health Service (Dental Charges)(Scotland) Amendment Regulations 2011* *SSI 168* came into force on 23 March 2011 and made various amendments to the principal 2003 dental charges regulations.

*The National Health Service Superannuation Scheme (Scotland) Amendment Regulations 2011* *SSI 173* come into force on 1 April 2011 and make minor drafting amendments to the principal 2011 superannuation regulations.

## Public health

*The Healthcare Improvement Scotland (Fees) Regulations 2011* *SSI 33* come into force on 1 April 2011 and prescribes the maximum fees which may be imposed by Healthcare Improvement Scotland for registration of an independent health care service from 1 April 2011. The maximum fees applicable are

- registration - £3,620
- annual continuation - £152
- variation /cancellation - £328.

*The Healthcare Improvement Scotland (Requirement for Reports) Regulations 2011* *SSI 34* come into force on 1 April 2011 and require Healthcare Improvement Scotland to submit any inspection report to the Scottish Ministers as soon as reasonably practicable.

*The Healthcare Improvement Scotland (Applications and Registrations) Regulations 2011* *SSI 35* come into force on 1 April 2011 and specify the information to be provided to support an application for registration of an independent healthcare service from 1 April 2011. The regulations also

- set out who may not apply to provide an independent healthcare service
- require Healthcare Improvement Scotland to keep a register of all independent healthcare services.

*The Healthcare Improvement Scotland (Transfer of Property) Order 2011* *SSI 156* comes into force on 31 March 2011 and provides for the transfer on 1 April 2011 of the property and liabilities held by NHS Quality Improvement Scotland to Healthcare Improvement Scotland.

*The Healthcare Improvement Scotland (Requirements as to Independent Health Care Services) Regulations 2011* *SSI 182* come into force on 1 April 2011 and set out requirements for providers of independent healthcare services by

- requiring providers to prepare a patient care record for each welfare service user
- specifying persons who are not fit to provide, manage or be employed in an independent healthcare service
- making provision as to fitness of premises, staffing and facilities for service users
- requiring providers to ensure the service delivered is of an appropriate quality
- establishing a complaints service.

Failing to comply with certain provisions of these regulations is an offence.

*The Healthcare Improvement Scotland (Inspections) Regulations 2011 SSI 184* come into force on 1 April 2011 and make provisions concerning inspections carried out by persons authorised by Healthcare Improvement Scotland. The regulations include provision that the information gathered for one inspection may be shared for the purposes of an inspection carried out by Social Care and Social Work Improvement Scotland.

## Key circulars

The following circulars can be obtained by using the hyperlinks, and are available to auditors on the TSU intranet/extranet.

### Chief executive letters (CEL)

*CEL(2011)4 Supplementary medical staffing – guidance to boards*. See Other developments – Pay modernisation and workforce planning – Framework on supplementary medical staff.

*CEL(2011)8 NHSScotland property transactions handbook 2011*. See Other developments – Capital – Revised property transaction handbook.

### PCA

*PCA(P)(2011)3 Additional pharmaceutical services Chronic medication service – implementation payments for contractors opening from 1 January 2011* . See Other developments – Pay modernisation and workforce planning – 2010/11 pharmacy remuneration arrangements.

### PCS

*PCS(AFC)(2011)1 Agenda for change: Payment of on-call allowances and call outs during periods of sick leave.* See Other developments – Pay modernisation and workforce planning – On call arrangements.

*PCS(AFC)(2011)2* *Extension of protected on-call arrangements under agenda for change beyond 31 March 2011.* See Other developments – Pay modernisation and workforce planning – On call arrangements.

*PCS(AFC)(2011)3* *Additional public holiday – royal wedding 2011.* See Other developments – Pay modernisation and workforce planning – Additional public holiday.

*PCS(DD)(2011)1* *Additional public holiday – royal wedding 2011.* See Other developments – Pay modernisation and workforce planning – Additional public holiday.

*PCS(AFC)(2011)4* *Scottish living wage.* See Other developments – Pay modernisation and workforce planning – The Scottish living wage.

## Dear colleague letters

*Dear colleague letter on the statement of internal control.* See Governance developments – Corporate governance – 2010/11 statement of internal control guidance.

*Dear colleague letter on the 2010/11 NHS capital accounting manual.* See Accounting developments – 2010/11 capital accounting manual.

*Cabinet Secretary letter on review for staff earning over £100,000 per annum* See Other developments – Pay modernisation and workforce planning – Review of application of pay policies.

*Dear colleague letter on review for staff earning over £100,000 per annum*. See Other developments – Pay modernisation and workforce planning – Review of application of pay policies.

*Dear colleague letter on review of staff earning over £100,000 per annum – supplementary clarification* See Other developments – Pay modernisation and workforce planning – Review of application of pay policies.

*Dear colleague letter on assets lives supplementary paper*. See Accounting developments – Guidance on depreciation.

*Dear colleague letter on the 2010/11 NHS annual accounts manual.* See Accounting developments – 2010/11 accounts manual.

# Publications

The following publications can be obtained by using the hyperlinks.

## Audit Scotland

### Financial overview of the NHS in Scotland 2009/10

This report *Financial overview of the NHS in Scotland 2009/10* highlights the current financial health of the NHS and considers the challenges in a tighter financial climate. It is based largely on the 2009/10 audited annual accounts and auditors' reports of the NHS bodies and the SGHD. Key messages include

- The financial performance of the NHS was good in 2009/10, with all bodies meeting their financial targets, which was achieved through the delivery of significant planned efficiencies.
- All NHS bodies submitted their audited accounts by the deadline of 30 June 2010. Auditors reported that the audit process ran smoothly and that draft accounts and supporting schedules were of a good standard. Auditors provided unqualified audit opinions on the financial statements and the regularity of the expenditure incurred.
- Short-term forecasts suggest that NHS bodies will continue to meet their targets for 2010/11. To do this they will have to identify and deliver more cost savings than achieved in previous years, and at a level in excess of the 2% efficiency saving set by the Scottish Government.
- In the medium to longer term, pressure on NHS finances such as drug costs, demographic changes and pay costs will continue to increase, while funding levels are unlikely to increase at the rates experienced over the last decade.
- The NHS is responding to the challenges of the current financial climate, growing demand and other cost pressures. NHS bodies must continue to develop management arrangements which will support the difficult decisions they will have to take.

## Pay modernisation and workforce planning

### Paying GPs to improve quality

This briefing from the Audit Commission *Paying GPs to improve quality* focuses on how trusts in England discharge their duty to ensure that quality and outcomes framework payments to GPs are properly made.

The review specifically looked at exception reporting, which allows GPs to 'except' (i.e. exclude) certain patients from their returns for payment e.g. those who refuse to attend reviews. The overall exception rate increased in 2009/10 and there is significant variation by practice, with some having no exceptions while others except nearly all their relevant patients. However, no evidence was found of the systematic over-reporting exceptions. Nevertheless, the briefing recommends that trusts should understand the reasons for high or unexpected exception rates and take suitable action to ensure patients are only exception-reported for legitimate reasons.

The review also looked at arrangements for conducting visits to practices by trusts, and found that attitudes to such visits varied. Using assessors from outside the area may help address concerns over independence and overcome the difficulties some trusts found getting clinical assessors to participate in visits. Some trusts do not meet the standard of undertaking visits every three years, and variations were found in how they reported the outcome of visits to practices.

### Managing sickness absence in the NHS

This briefing from the Audit Commission *Managing sickness absence in the NHS* examines sickness absence in trusts in England. Sickness absence in the NHS is higher than in the private sector, particularly in regard to long-term absence. Overall, the sickness absence rate in English trusts is 4.4%, but rates vary significantly from less than 2% to higher than 6%.

Several factors contribute to the variation, some of which cannot be controlled by management, e.g. areas of deprivation have higher levels of absence, as do organisations with a low staff grade mix. The remaining variation that relates to systematic differences between organisations is the area that may be readily changeable by management action.

As well as the direct cost of sickness absence, there are additional indirect costs for temporary staff cover. Significant savings could be achieved if all trusts were able to reduce their sickness absence rates to the lower quartile.

## Performance management

### The procurement of consumables by NHS acute and foundation trusts

This report from the National Audit Office (NAO) *The procurement of consumables* considers the arrangements for the procurement of medical and other supplies by trusts in England. NHS trusts in England have freedom to decide on their own procurement arrangements for consumables. They can make use of a network of regional procurement hubs, and a national supplies and distribution organisation (NHS Supply Chain) or buy directly from suppliers. However, a combination of inadequate information and fragmented purchasing means that the procurement of consumables provides poor value for money. For example, there is wide variation, up to 50%, in the price paid for some items.

The report recommends that trusts consider procurement as a strategic priority, and should review their current consumables purchasing strategy. They also should consider options such as merging functions or outsourcing. It also recommends that the Department of Health should publish a procurement strategy to outline effective ways of holding trusts to account for their procurement practices.

By improving ordering processes, standardising product choices and achieving volume deals, trusts could save around 10%. For example, there is scope for efficiencies when publishing contract notices in the

Official Journal of the European Union. In addition, although trusts use of the NHS Supply Chain service has been below expectations, the projected cumulative savings are significant.

### The NHS landscape review

This report from the NAO *NHS landscape review* summarises the key changes proposed to the NHS in England as part of the Department of Health's plans to achieve efficiency savings and productivity improvements of around £20 billion over the next four years. Key changes include the following

- The Department will retain ultimate financial accountability to Parliament but will have less involvement in the day-to-day operation of the NHS. It will principally be responsible for setting strategic direction and ensuring that the different elements of the system work together.
- Primary care trusts and strategic health authorities will be abolished.
- Commissioning responsibilities will move to a new body called the NHS Commissioning Board from April 2012, which will be responsible for supporting quality and outcomes, directly commissioning some specialised services, and allocating and accounting for NHS resources. It will be held to account by the Secretary of State against a set of health outcomes indicators.
- Pathfinder GP consortia will be established in shadow form from April 2011.
- Monitor will become an economic regulator responsible for setting prices, promoting competition and safeguarding continuity of designated services.
- All trusts will either have foundation status by April 2014 or be merged with existing foundation trusts. They will be granted greater freedom, including the removal of the current cap on non-NHS income and statutory borrowing controls.
- As a result of the abolition of the Audit Commission, the intention is to have new arrangements in place for auditing England's local public bodies by 2012/13.

## Auditor action

The following is a summary of items in this chapter of the TB that recommend that auditors take certain actions

| Section | Action |
|---|---|
| Accounting developments – 2010/11 accounts manual | Auditors should confirm that their boards are aware of this guidance and consider the implications for the audit of the 2010/11 annual accounts. |
| Accounting developments – 2010/11 capital accounting manual | Auditors should confirm that their boards are aware of this guidance and consider the implications for the audit of the 2010/11 annual accounts. |

| | |
|---|---|
| Accounting developments – Guidance on depreciation | Auditors should confirm that their boards are aware of this guidance and, where appropriate, are taking steps to implement the methodology. |
| Governance developments – Corporate governance – 2010/11 guidance on statement of internal control | Auditors should confirm that their boards are aware of this guidance and that the disclosures in the SIC are not inconsistent with information of which they are aware. |
| Other developments– Pay modernisation and workforce planning – Review of salaries over £100,000 | Auditors should confirm that their boards are aware of this guidance, are taking steps to undertake the review and that their proposed sample size and methodology will meet external audit requirements. |

# Central government chapter

## Introduction

This chapter contains articles on central government technical developments and guidance relevant to external auditors' responsibilities under their audit appointment to give an opinion on the financial statements. It should be read by external auditors with appointments in the central government sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance and urgent issue notes).

The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to auditors on the TSU intranet/extranet.

In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that the following articles in this chapter relate to 2010/11 audits

- note for guidance on auditing 2010/11 financial statements
- amendments to 2010/11 FReM
- new discount rate for pension liabilities
- guidance on new compensation scheme.

There are also articles on the 2011/12 FReM and the 2011/12 pensions earnings cap.

## TSU developments

### Publications

The following note has been published by the TSU since TB 2010/4 and is available to auditors on the TSU intranet/extranet. It can be sent to other TB recipients on request.

#### Note for guidance on auditing 2010/11 central government financial statements

The TSU has published *Note for guidance 2011/2(CG) 2010/11 central government financial statements* to provide auditors with guidance on auditing the 2010/11 financial statements.

# Accounting developments

The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to auditors on the TSU intranet/extranet.

## Amendments to 2010/11 FREM

HM Treasury has issued amendments to the *2010/11 Government financial reporting manual* (the FReM). They are briefly summarised in the following paragraphs.

**Disclosures for senior staff**

There are amended disclosure requirements in respect of senior staff

- Paragraph 5.2.19 requires performance pay or bonuses to be separately reported from salaries in £5,000 bands in the remuneration report.
- Paragraph 5.2.18 has been amended to clarify that bonuses reported in the remuneration report should be consistent with those disclosed in the financial statements.

**Exit packages**

Paragraph 5.4.66 has been added to require bodies to provide summary data on their use of exit packages agreed in year as a note, in the format agreed by the Cabinet Office. The disclosures are required to cover payments made under any applicable compensation scheme, including the *Civil service compensation scheme*, and special severance payments.

**Authorised for issue date**

Paragraph 5.4.24(b) previously required the date the accounts were authorised for issue to be disclosed on the frontispiece of the accounts, below the title. However, this has been amended to state that it should not be included on the title page.

**True and fair override**

The true and fair override provision has been reinstated at FReM paragraph 2.2.6, for use in exceptional circumstances, applying the principles set out in IAS 1.

The provision for a true and fair view override was removed from the 2009/10 FReM on the basis that the reference in IAS 1 would preclude the necessity to include it. However, while the reference in IAS 1 is sufficient to override IFRS, it cannot be used to override the FReM, and therefore the provisions have been reinstated.

**Auditor action**

Auditors should confirm that their bodies are aware of these changes and are making the necessary arrangements to comply.

## 2011/12 FREM

HM Treasury has issued the 2011/12 edition of the *FReM*.

The main change from the 2010/11 FReM is in respect of the treatment of assets financed by government grant and donations from a non-government source. Under previous requirements, they were taken to the government grant reserve and donated asset reserve respectively, and released to the statement of comprehensive net expenditure over the life of the relevant asset. This treatment was based on *IAS 20 Accounting for government grants*.

An interpretation of IAS 20 has been added so that grants and donated assets should be recognised immediately, unless there is a condition that the recipient had not satisfied that would lead to repayment. Most grants and donated assets should be recognised as income, but grants from a sponsoring department to a non-departmental public body (NDPB) should be credited to general reserves. As a consequence, the government grant reserve and donated asset reserve no longer exist.

There is also a new disclosure requirement, as part of the property, plant and equipment note, in the year the asset is acquired, to separately disclose the fair value of those assets funded by government grant, donation or lottery funding. Where the funder provides cash, rather than the physical assets, any difference between the cash provided and the fair value of the assets acquired should also be disclosed.

Auditors should confirm that their bodies are aware of these changes and are making the necessary arrangements to comply.

Other changes include the following

- Paragraph 1.1.5 has been amended to reflect that this edition of the FReM applies EU adopted IFRS and Interpretations in effect for accounting periods commencing on or before 1 January 2011.
- The format of the statement of parliamentary supply has been amended (applies to Westminster departments only).
- The departmental resource accounting boundary has been altered to include NDPBs (it is not expected that this will apply in Scotland).
- The requirements for tax credits at paragraph 11.2.5 and 13.3.8 have been amended.

## Discount rate for pension liabilities

Treasury has issued *PES(2010)17 New discount rate for valuing pension liabilities* which advises that the discount rate for pension liabilities will change from 1.8% real to 2.9% real from 31 March 2011. It clarifies that this will effect the accounting arrangements as follows

- The pension liability at 31 March 2011 will be discounted at the new rate, resulting in a decrease in the value of the pension liability. The change in value will be reflected through reserves (statement of changes in taxpayers' equity) and will not affect the statement of comprehensive net expenditure or revenue account for 2010/11.
- There will be a change in the interest charge to the statement of comprehensive net expenditure in 2011/12 as a result of a higher level of discount being unwound but applied to a lower starting liability figure.
- There will also be a lower current service cost for 2011/12.

The discount rate for general provisions is currently 2.2% real and is valid until 31 March 2011.

# Other developments

The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to auditors on the TSU intranet/extranet.

## Post employment benefits

### 2011/12 pensions earning cap

The Cabinet Office has issued *EPN 294 Increase in the pensions earning cap 2011/12* to set out the final salary pensions earning cap for 2011/12.

The rules of the civil service pension scheme limit the amount of salary that can be used in calculating the pensionable pay of civil servants who joined since 1 June 1989, i.e. contributions can only be calculated on their salary below the earnings cap.

For the period 6 April 2011 to 5 April 2012, this cap on earnings is £129,600.

## Compensation scheme

### Guidance on new scheme

The Civil Service has issued *Civil service compensation scheme – guidance for employers* to provide guidance on the new civil service compensation scheme (CSCS). The CSCS sets out the compensation that departments can pay their staff if they leave under early departure arrangements. The scheme applies to staff covered by the civil service pension and compensation arrangements. There are the following three categories of early departure under the new CSCS

- Voluntary exit can be offered to reduce staff numbers. The standard tariff for staff below normal pension age is one month's pay for each year of service up to 21 months, and above normal pension age the maximum is six months. However, departments have some discretion over the terms on offer.
- Voluntary redundancy must be offered where the employer has begun formal consultation with the Unions about possible redundancies. Employers are required to offer the standard voluntary tariff.
- Compulsory redundancy, where the standard tariff is one month's pay per year of service up to 12 months. However, any member of staff who was turned down for voluntary redundancy and is later selected for compulsory redundancy will receive voluntary redundancy terms.

The schemes require Cabinet Office approval before they can be launched. Staff will be given three months' notice which may be paid in lieu.

The new scheme gives extra protection to the lower paid, as staff earning less than £23,000 will be treated as if they earn £23,000 for the purpose of calculating redundancy payments. Employers also have discretion to offer such protection in the case of voluntary exits. The scheme sets a cap on payments for higher earners of £149,820.

## Section 22 reports

Under *section 22(3) of the Public Finance and Accountability (Scotland) Act 2000*, the Auditor General may prepare a report to Scottish Ministers on the accounts sent to him by auditors. The following reports have been prepared since TB 2010/4 and can be obtained by using the hyperlinks.

### The 2009/10 audit of The National Library of Scotland

The Auditor General issued this report on the *2009/10 Audit of the National Library of Scotland* to bring to Parliament's attention a qualified opinion on the regularity of expenditure in the National Library of Scotland Accounts.

The qualification was due to a financial irregularity relating to procurement and invoicing which has an estimated value in excess of £500,000. The body identified the irregularity while introducing a new finance system. It has strengthened its procedures by requiring managers to examine procurement methods used before authorising expenditure. The new finance system will require orders to be approved before any expenditure is committed, and will also provide improved reporting and scrutiny of non-contracted expenditure and suppliers.

## The 2009/10 audit of the Scottish Government consolidated accounts

The Auditor General issued this report on the *2009/10 Audit of The Scottish Government Consolidated Accounts* to bring to Parliament's attention that the Scottish Government consolidated accounts for 2009/10 were not qualified. It also advises that, overall, the Scottish Government and associated bodies managed their budgets well in 2009/10 with outturn being within 1% of the budget as a whole.

The report highlighted that, in order for Parliament to exercise adequate scrutiny of the proposed budget, it is important that high quality and detailed financial information is available. There is scope for

- improved clarity of reporting to Parliament the reasons for proposed budget changes at the autumn and spring budget revisions
- provision of more detailed financial information to Parliament on outturn against budget and results achieved from spending.

## Auditor action

The following is a summary of items in this chapter of the TB that recommend that auditors take certain actions

| **Section** | **Action** |
|---|---|
| Accounting developments – Amendments to 2010/11 FReM | Auditors should confirm that their bodies are aware of the changes to the 2010/11 FReM and are making the necessary arrangements to comply. |
| Accounting developments – 2011/12 FReM | Auditors should confirm that their bodies are aware of the new requirements in the 2011/12 FReM and are making the necessary arrangements to comply. |

# Further education chapter

## Introduction

This chapter contains articles on further education technical developments and guidance relevant to external auditors' responsibilities under their audit appointment to give an opinion on the financial statements. It should be read by external auditors with appointments in the further education sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance and urgent issue notes).

## Key circulars

The following circulars can be obtained by using the hyperlinks, and are available to auditors on the TSU intranet/extranet.

### SFC circulars

*SFC/06/2011 Additional funding for student support 2010/11* announces additional funding for student support for 2010/11.

*SFC/08/2011Final fee waiver grant 2009/10* provides details of the final fee waiver claims for 2009/10.

# Contact points

Specific enquiries or requests for further information relating to articles contained in each chapter of this TB should be made to

| | |
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# Technical bulletin 2011/2

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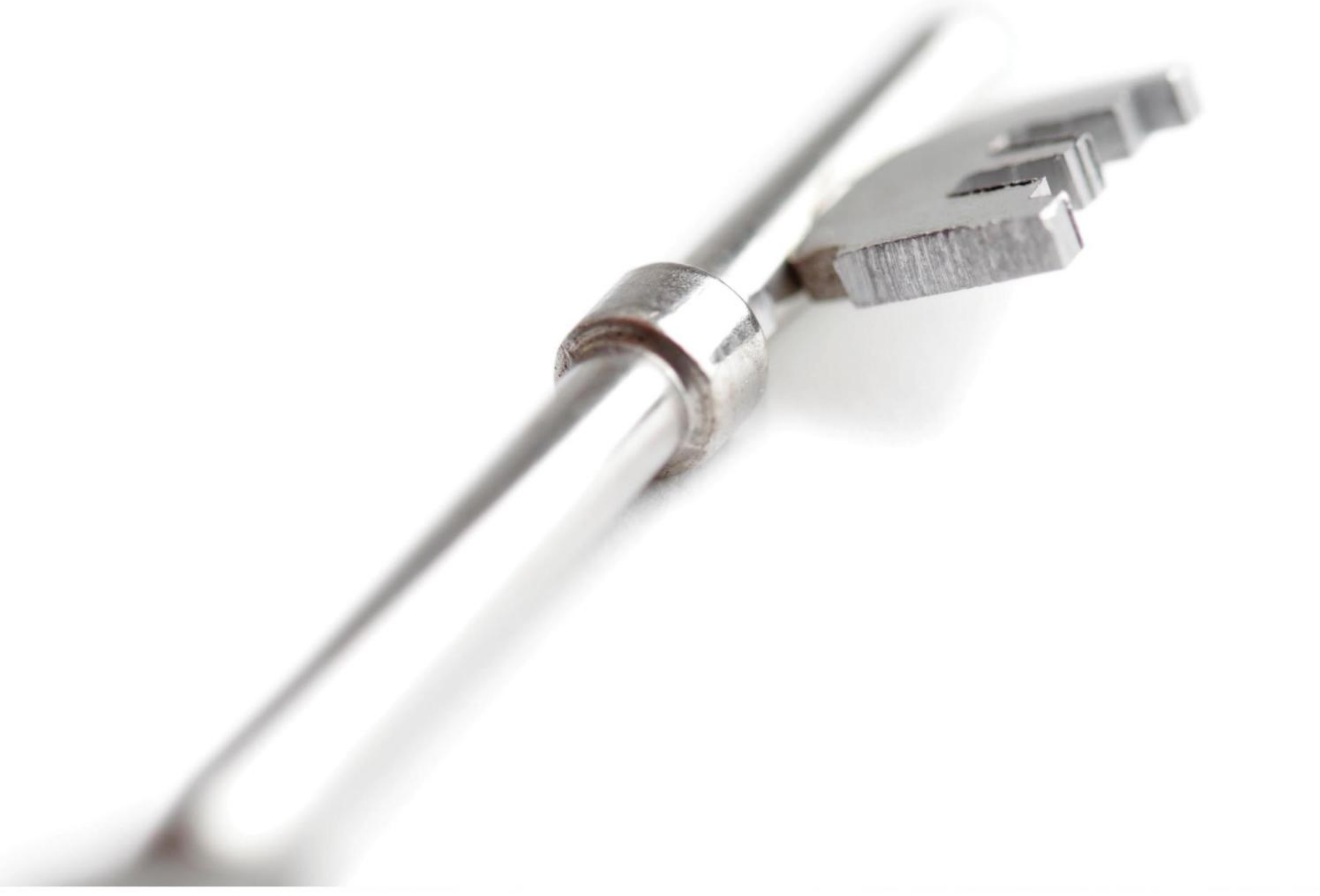

# Contents

# Foreword

Audit Scotland's Technical Services Unit (TSU) provides guidance and support to external auditors appointed by the Accounts Commission and Auditor General to assist them fulfil their responsibility under their audit appointment to give an opinion on the financial statements.

This includes the publication of technical bulletins (TBs) at quarterly intervals onto the TSU intranet and Audit Scotland website. The purpose of TBs is to summarise technical developments in the quarter for external auditors, and to provide auditors with guidance where required.

TBs frequently recommend that auditors take certain actions, and a summary of these actions is provided at the end of each chapter. It is important that a mechanism is in place for senior audit staff to review the TB promptly and to ensure that steps are taken to consider such recommendations.

While auditors act independently of Audit Scotland, and are responsible for their own conclusions and opinions, consistency of opinions in similar circumstances is important and **it is expected therefore that auditors will normally follow all TSU guidance. Auditors should advise the TSU promptly if they disagree with, and may intend not to follow, any guidance provided on an important issue** (e.g. a matter that required consideration to be given to the qualification of the accounts of a number of audited bodies).

TBs are also published on the Audit Scotland website so that audited bodies and other stakeholders can be aware of the guidance that has been issued to auditors. In selecting items for inclusion in TBs the bias is towards those which are of particular interest to external auditors. TBs should not therefore be regarded as providing an exhaustive review of all matters relevant to audited bodies.

Audit Scotland makes no representation as to the completeness or accuracy of the contents of TBs or that legal or technical guidance is correct. Points of law, in particular, can ultimately be decided only by the Courts. Audit Scotland accepts no responsibility for any loss or damage caused as a result of any person relying upon anything contained in a TB.

# Cross-sectoral chapter

## Introduction

This chapter contains articles on cross-sectoral technical developments and guidance relevant to external auditors' responsibilities under their audit appointment to give an opinion on the financial statements. It should be read by all external auditors. Developments and guidance that are relevant to only one sector are covered in the relevant sector-specific chapter. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance, urgent issue notes and, for local authorities, grant notes).

The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to inhouse auditors on the TSU intranet.

In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that the note for guidance on model auditor's reports in this chapter relates to 2010/11 audits.

There are also articles in this chapter on the following subjects: new accounting standards on consolidated financial statements, joint arrangements, interests in other entities, and fair value measurement; amended standard on post employment benefits; amendment to standard in respect of other comprehensive income; new *Code of audit practice*; proposed revised standard on assurance engagements; and consultation on auditor reporting.

The TSU encourages feedback on this TB. Comments should be sent to alewis@audit-scotland.gov.uk.

## TSU developments

### Publications

The following note has been published by the TSU since TB 2011/1. It can be obtained by using the hyperlink and is available to inhouse auditors from the TSU intranet.

#### Note for guidance on 2010/11 model auditor's reports

The TSU has published *Note for guidance 2011/5 2010/11 model auditor's reports* to provide auditors with model reports on the financial statements, and guidance on their use, for 2010/11.

## Other matters

### Extranet

The Extranet site maintained by the TSU provided auditors (principally the firms) with an online library of key technical information and guidance documents, published both by the TSU and other organisations. The Extranet was hosted by an external company and, due to circumstances outwith the TSU's control, all information on the site has been lost with no possibility of recovery.

The technology on which the Extranet was based is old and there were already plans to replace it before the end of this year. Temporary arrangements are being put in place to minimise as far as possible the impact on service delivery in the meantime including

- regular updates by email on the technical documents published by other organisations, and guidance documents published by the TSU
- making recent notes for guidance and grant notes, and technical bulletins covering the last two years, available from a page on the Audit Scotland website
- providing any other document previously on the TSU pages of the Extranet on request.

# Accounting developments

The new accounting standards referred to in the following articles can be ordered from www.ifrs.org. They are effective in the private sector for annual periods beginning on or after 1 January 2013, with earlier application permitted, except where indicated. The application dates for the public sector have yet to be determined.

## New standard on consolidated financial statements

The International Accounting Standards Board (IASB) has issued *IFRS 10 Consolidated financial statements* which establishes principles for the preparation of consolidated financial statements when an entity controls other entities. IFRS 10 replaces *IAS 27 Consolidated and separate financial statements* and *SIC 12 Consolidation - Special purpose entities*.

IAS 27 uses control as the basis for consolidation, while SIC 12 focuses more on risks and rewards. IFRS 10 identifies control as the single basis for consolidation for all types of entities. Also, IAS 27 focuses on the power to govern the financial and operating policies for assessing control. The IFRS 10 definition of control reflects that an investor can achieve power over an investee in many ways, not just through governing financial and operating policies. It provides a definition of control that comprises the following three elements

- power over an investee

- exposure, or rights, to variable returns from an investee
- ability to use power to affect the reporting entity's returns.

Although exposure to risks and rewards is an indicator of control, it is not the sole focus for consolidation. The investor must assess whether it has rights to direct the relevant activities, and IFRS 10 sets out requirements for situations when control is difficult to assess. It states that an investor can control an investee with less than 50% of the voting rights, and provides specific application guidance for assessing control in such cases. This was not explicit in IAS 27.

IFRS 10 also contains specific application guidance for agency relationships. When decision-making authority has been delegated by a principal to an agent, the agent does not control the entity, and it is the principal that would consolidate it. The application guidance offers a range of factors to consider and contains examples.

The accounting requirements and consolidation procedures are unchanged from IAS 27.

## New standard on joint arrangements

The IASB has issued *IFRS 11 Joint arrangements* which establishes principles for the financial reporting of parties to a joint arrangement. IFRS 11 supersedes *IAS 31 Interests in joint ventures* and *SIC 13 Jointly controlled entities - Non-monetary contributions by venturers*.

The only driver for the accounting under IAS 31 is whether an arrangement is structured through an entity. IFRS 11 establishes the principle that the classification of a joint arrangement should be determined by assessing the rights and obligations of the parties arising from that arrangement as follows

- A party with rights to the assets (and obligations for the liabilities) relating to the arrangement is a party to a joint operation. A joint operator accounts for assets, liabilities and corresponding revenues and expenses arising from the arrangement.
- A party with rights to the net assets of the arrangement is a party to a joint venture. A joint venturer accounts for an investment in the arrangement using the equity method.

IAS 31 gave entities a choice to apply the proportionate consolidation method, but IFRS 11 requires the equity method to be used.

## New standard on disclosure of interests in other entities

The IASB has issued *IFRS 12 Disclosure of interests in other entities* which sets out disclosure requirements for subsidiaries, joint arrangements, associates, special purpose entities (SPEs) and other off balance sheet vehicles.

It requires information to be disclosed on the nature and financial effects of the reporting entity's relationship with other entities. It establishes objectives that require an entity to disclose information that helps users

- understand the judgements and assumptions made by a reporting entity when deciding how to classify its involvement with another entity
- assess the nature of the risks associated with interests in other entities.

## New standard on fair value measurement

The IASB has issued *IFRS 13 Fair value measurement* which sets out a framework for measuring fair value. The framework applies to all transactions involving fair value measurement, except leasing transactions covered by *IAS 17 Leases*.

IFRS 13 defines fair value as the price that would be received to sell an asset, or paid to transfer a liability, between market participants (i.e. an exit price). It emphasises that fair value is a market-based measurement that takes into account the conditions at the measurement date. It specifies that a fair value measurement should assume that the transaction takes place in the principal market for the item (i.e. the market with the greatest volume and level of activity) or, in the absence of a principal market, the most advantageous market.

An entity can estimate a transfer price for a liability using the fair value of the corresponding asset or the amount that would be incurred in fulfilling the obligation.

IFRS 13 requires entities to disclose information on the valuation techniques and inputs used to measure fair value, as well as information about the uncertainty inherent in the measurements.

## Amended standard on post employment benefits

The IASB has issued an amended *IAS 19 Employee benefits* which contains changes to the accounting for post employment benefits. The amended standard simplifies the reporting of changes in defined benefit plans by introducing a new method of disaggregating defined benefit cost, known as the net interest approach. Under the new requirements, the change in the net liability or asset is disaggregated into

- service cost, which is the additional liability that arises from employees providing service during the period
- net interest, which is the interest expense on the net defined benefit liability or interest income on the net asset. Net interest is determined by multiplying the liability or asset by the discount rate used to determine the defined benefit obligation
- re-measurements, which are other changes in the value of the defined benefit obligation, such as changes in estimates and other changes in the value of plan assets.

This approach replaces the expected return on assets and interest cost on the obligation in the current standard with a single net interest component. It requires entities to include service cost and net interest in profit or loss, and re-measurements in other comprehensive income.

There are also changes to disclosure requirements that are intended to show the characteristics of defined benefit plans and the risks arising. This includes a requirement for entities that participate in multi-employer plans to provide a description of any withdrawal or wind-up agreement.

The amendments also eliminate the option to defer the recognition of some gains and losses (i.e. the corridor approach), although this option was not available to public sector bodies in any event.

In addition, the amendments also incorporate a change to the accounting for termination benefits. It requires an entity to recognise termination benefits when they can no longer withdraw that offer (e.g. when an employee accepts the offer).

### Amendment to standard on other comprehensive income

The IASB has issued *Presentation of items of other comprehensive income (Amendment to IAS 1)* which contains changes to the presentation of items of other comprehensive income in *IAS 1 Presentation of financial statements.* IAS 1 defines a complete set of financial statements, including a statement of comprehensive income. IAS 1 requires all income and expense items to be presented in the profit or loss section of that statement, unless a standard requires it to be presented in a separate section called other comprehensive income (OCI). Examples of items presented in OCI are actuarial gains and revaluations of property, plant and equipment. The main changes in the amendment are

- a new requirement for entities to group items presented in OCI on the basis of whether they would be reclassified to profit or loss at a later date, when specified conditions are met. However, the amendment does not cover which items are presented in OCI or which items need to be reclassified. This may be addressed at a later date.
- the title of the statement has been changed to the statement of profit or loss and other comprehensive income.

The amendment is effective in the private sector for financial years beginning on or after 1 July 2012. The application of this amendment to the public sector has yet to be determined.

## Auditing developments

The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.

## New code of audit practice

Audit Scotland has published a new *Code of audit practice* to apply from 2011/12 audits. The Code is part of the overall framework for the conduct of public audit in Scotland. It outlines the responsibilities of external auditors (Audit Scotland staff and private firms) and explains how they should carry out their functions under the *Public Finance and Accountability (Scotland) Act 2000* or the *Local Government (Scotland) Act 1973*. It is a condition of their appointment that auditors follow it.

The Code emphasises that public audit strengthens accountability, both to the elected or appointed members, and to consumers, taxpayers and the wider community. Public audit is therefore planned and undertaken from a wider perspective than in the private sector, which means providing assurance not only on the financial statements, but also on regularity, propriety, performance and the use of resources. Public sector auditors' main objectives are therefore to

- provide an opinion on audited bodies' financial statements and, where required, the regularity of transactions
- review and report on other information published with the financial statements, including the annual governance statement and remuneration report
- review and report on audited bodies' corporate governance arrangements, financial position, and arrangements to manage performance
- examine and report on grant claims and other returns.

In revising the Code, Audit Scotland has considered how the benefits of audit can be maximised while minimising the financial burden on audited bodies. The most significant changes have been to reflect developments in the way that the best value audit is conducted, the introduction of shared risk assessments of councils, and the new requirement for auditors to report separately on the audit of local government pension funds.

## Proposed revised standard on assurance engagements

The International Auditing and Assurance Standards Board (IAASB) has issued *ISAE 3000 (Revised) Assurance engagements other than audits or reviews of historical financial information – exposure draft* which contains a proposed revised international standard on assurance engagements.

Consistent with the extant standard, it is proposed that two levels of assurance are possible for engagements, i.e. reasonable assurance and limited assurance. However, the proposed standard introduces additional guidance to help readers better understand the differences between them. For example, the opinion in a reasonable assurance engagement is on the underlying subject matter, while in a limited assurance engagement it is expressed in the form that nothing has come to the practitioner's attention to cause them to believe the subject matter is materially misstated.

Comments should be made via the IAASB website by 1 September 2011.

## Consultation on auditor reporting

The IAASB has issued a consultation paper entitled *Enhancing the value of auditor reporting: Exploring options for change* on enhancing the quality, relevance and value of auditor reporting. It explains that there is a view among users of financial statements that there is richer information in respect of the entity and the audit itself than is currently being provided. Users have expressed the wish to obtain this richer information directly from the entity and/or through communications on the auditor's insight into such matters. They believe such information would assist them in assessing the financial condition and performance of the entity, as well as the quality of both its corporate reporting and the audit.

The paper suggests that this 'information gap' could be narrowed by the disclosure of additional information provided by management, those charged with governance, or the auditor. It is suggested that the auditor could report on

- key business, operational and audit risks the auditor believes exist
- the auditor's perspective on the key assumptions underlying the judgments that materially affect the financial statements
- the appropriateness of the accounting policies, and any changes that have a significant impact
- key audit issues and their resolution
- quality and effectiveness of the governance structure and risk management.

Comments should be submitted by 16 September 2011 via the IAASB website.

# Legislation

The following items of legislation can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.

## Statutory instruments

### Pensions

*The Pensions Increase (Review) Order 2011*, *SI 827* came into force on 11 April 2011 and provided for the increase in the rates of public service pensions for 2010/11

- For pensions which began before 12 April 2010, the increase is 3.1%.
- For pensions which began on or after that date, the increases are set out in the Order.

## Charties

*The Scottish Charitable Incorporated Organisations (Removal from Register and Dissolution) Regulations 2011, SSI 237* came into force on 1 April 2011 and set out a process for the dissolution of Scottish charitable incorporated organisations (SCIOs)

- Applications by SCIOs require to be made to the Office of the Scottish Charity Regulator (OSCR).
- A SCIO failing to meet the charity test may be ordered by OSCR to apply for dissolution.

# Publications

The following publication can be obtained by using the hyperlink, and is available to inhouse auditors on the TSU intranet.

## Accounting

### Cutting clutter – combating clutter in annual reports

This report from the Accounting Standards Board entitled *Cutting clutter – combating clutter in annual reports* considers how best to reduce clutter in annual reports. Clutter is described as immaterial disclosures that inhibit the ability to identify and understand relevant information. This includes, for example, detailed notes supporting line items that are insignificant, and explanatory information that remains unchanged from year to year.

The report states that clutter undermines the usefulness of annual reports and accounts by obscuring important information and preventing a clear understanding of the organisation and the issues that it faces. It sets out a number of aids for reducing clutter, including illustrative disclosures of narrative and notes to the financial statements.

# Local authority chapter

## Introduction

This chapter contains articles on local authority technical developments and guidance relevant to external auditors' responsibilities under their audit appointment to give an opinion on the financial statements and to certify grant claims. It should be read by external auditors with appointments in the local authority sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance, urgent issue notes and grant notes).

The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to inhouse auditors on the TSU intranet.

In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that the following articles in this chapter relate to 2010/11 audits

- note for guidance on remuneration reports, and grant notes on various grant claims
- TSU guidance on the audit of pension contributions, and supporting information for benefits claims
- guidance on moving to the consumer price index for retirement benefit increases
- statutory and other guidance on impairing Icelandic bank deposits
- guidance on 2010/11 accounts
- guidance on group accounts
- statutory guidance on capital grants and contributions
- statutory guidance on investment properties
- guidance on remuneration reports
- guidance on governance compliance statement

- module 5 of HBCOUNT.

# TSU developments

## Publications

The following note has been published by the TSU since TB 2011/1. It can be obtained by using the hyperlink and is available to inhouse auditors from the TSU intranet.

### Note for guidance on remuneration reports

The TSU has published *Note for guidance 2011/6(LA) Remuneration reports* to provide auditors with guidance on auditing remuneration reports from 2010/11.

### Grant notes

Grant notes (GNs) are published to provide local authority auditors with guidance on the audit of approved grant claims. The TSU has published the following GNs since TB 2011/1

- *GN/GEN/11 General guidance on the audit of approved local authority grant claims*
- *GN/EMA/11 2010/11 education maintenance allowance grant*
- *GN/FPN/11 2010/11 safety camera partnership grant*
- *GN/HBS/11 2010/11 housing and council tax benefit subsidy claim*
- *GN/CJS/11 2010/11 criminal justice social work services grant claim*.

## Other guidance

### Pension funds – audit of contributions

The fund account in the financial statements of pension funds is required to present employer and employee contributions for the year. Under *The Local Government Pension Scheme (Benefits, Membership and Contributions)(Scotland) Regulations 2008*, responsibility for calculating the contributions lies with the employing authority rather than the pension fund. However, it is considered good practice for each pension fund to review the figures received from employing authorities to identify any discrepancies.

Auditors of the pension funds should consider the assurances the fund has obtained from the employing authorities in respect of the contributions received. If auditors conclude that the assurance is insufficient, testing of the contributions is required. Testing should aim to confirm that

- contributions are at the correct rate
- the rate is applied to correct salaries
- the contributions are from/on behalf of all members, and only members.

It is expected that the testing of contributions will have been carried out as part of the payroll testing at the employing authorities. Auditors of employing authorities should provide assurance to the pension fund auditor that, within their testing of payroll, they have tested pension deductions and remittances and there are no

- matters arising that could impact on accounting to the pension fund for deductions
- audit findings expected to be material to the employer
- issues to be reported to those charged with governance.

Where auditors of employing authorities are not in a position to give this assurance, further testing of contributions will be required. It is considered most efficient if the testing is carried out by the auditor of the employing authorities. In the event this is not possible, arrangements should be made for the auditor of the pension fund to visit the employing authority to undertake the testing directly.

Auditors of pension funds should contact the auditors of employing authorities to ensure arrangements for providing the necessary assurances are satisfactory.

## Benefits claims – supporting information

TB 2010/3 (page 20) advised that, for the purposes of auditing benefit subsidy, claims do not have to be supported by the original claim form, provided other acceptable supporting information is available. The Department for Work and Pension (DWP) has informed the TSU that the supporting information should demonstrate that a claim form was received, and that examples that may be acceptable include

- letters or other records of communication from the claimant about changes in circumstances
- copies of information supporting the levels of income, capital or rent
- responses from the claimant to enquiries from the local authority
- copies of records of reviews of the claim
- information from the DWP where the benefit is passported.

The DWP has advised that this list is not exhaustive and where there is any doubt about the alternative information held by an authority, auditors should note this in their covering letter.

This guidance from the DWP impacts on paragraph 60 of GN/HBS/11 which requires claims to be supported by 'current prime documents'. This requirement should therefore be interpreted in light of the DWP guidance.

## Accounting developments

The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.

### Guidance on moving from RPI to CPI for retirement benefits

The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued *LAAP bulletin 89 The change from retail prices index to consumer prices index for pensions increases* to provide guidance on accounting for the replacement of the retail prices index (RPI) with the consumer prices index (CPI) for retirement benefits. It is intended to assist authorities in implementing the requirements of *UITF abstract 48 Accounting implications of the replacement of the retail prices index with the consumer prices index for retirement benefits* (see TB 2011/1 – page 4).

The bulletin states that any reduction in liabilities arising from the change could potentially be recognised in the comprehensive income and expenditure statement (CIES) in

- the surplus or deficit on the provision of services, as a change in benefit. This would present the move as a negative past service cost; or
- other comprehensive income and expenditure, within actuarial gains or losses on pension assets and liabilities, as resulting from a change in assumptions. This would mean that the previous assumption that future benefit payments would be uplifted by RPI was incorrect.

It should be noted that neither presentation would impact on the general fund as they do not form part of actual contributions made in the period.

UITF 48 indicates that treatment as a change in benefit would occur where there is an obligation to pay pension increases based on RPI, and that this may occur due to the explicit terms of the scheme rules or where a constructive obligation has arisen. The bulletin focuses on considering the extent to which there may be a constructive obligation.

UITF 48 states that an employer's public statement or past practice gives rise to a constructive obligation where the entity has created a valid expectation that it will pay certain employee benefits. The bulletin states that the strongest support for recognising a constructive obligation is the extent to which the expectation of RPI-based increases has been communicated by government to pension scheme administrators (and by scheme administrators to pension scheme members). For example

- National literature for employees that explained that benefits would have been protected against cost of living increases may have referred to that increase being based on RPI.
- Guidance to employers from the government may also have referred to RPI, which would have been considered by the various pension committees, and may have been communicated to employees.

There is therefore sufficient cause to conclude that a constructive obligation has arisen and the change should therefore be accounted for as a change in benefit. Authorities may choose to challenge this conclusion but they would need to demonstrate that, for example, locally produced pension information was worded so as to ensure employees could not reasonably infer that future rises would be based on RPI.

The bulletin recommends that authorities include a suitable narrative disclosure note to the post-employment benefits assets and liabilities reconciliation, and provides suggested wording for each treatment.

Auditors may find it useful to refer to this bulletin when confirming that authorities have properly accounted for the change from RPI to CPI.

## Guidance on impairing deposits in Icelandic banks

### New statutory guidance

The Scottish Government has issued *Finance circular 5/2011 Accounting for investments – Icelandic banks* which contains statutory guidance that sets out the impairments in respect of deposits in failed Icelandic banks that should be charged to the general fund from 2010/11.

The Scottish Government's original statutory guidance issued in March 2009 (see TB 2009/1 – page 20) permitted local authorities to postpone from 2008/09 to 2010/11 charging to the general fund impairment losses arising from deposits with the failed Icelandic bank deposits. That guidance permitted authorities to make statutory credits to the general fund that require to be reversed in 2010/11. This new statutory guidance permits a local authority to limit the losses charged to the general fund in 2010/11 to the anticipated actual cash loss (i.e. future cash-flows are not discounted to recognise the time value of money). Authorities choosing to apply this guidance are required to calculate the following amounts

- The cumulative adjusted impairment loss, which is defined as the cumulative value of the impairment recognised in the CIES for a relevant investment in all financial years commencing 2008/09 less the cumulative value of interest receivable credited to that statement.
- The anticipated cash loss, which is defined as either the claim value (if it has been accepted) or the initial cash deposit value, less the amount the authority estimates that it will receive from the administrator.

If the cumulative adjusted impairment loss is greater than the anticipated cash loss, a statutory credit equal to this difference may be made to the general fund. The debit should be charged to a new Icelandic banks statutory adjustment account. The guidance requires a note to be disclosed that sets out the statutory adjustments that have been made.

Auditors should confirm that authorities comply with this guidance where they choose to apply it.

## Updated guidance impairment estimation

CIPFA has issued *LAAP bulletin 82 Guidance on the impairment of deposits with Icelandic banks – Update 4* to provide updated guidance on estimating the impairments to be recognised in 2010/11 for deposits in Icelandic banks. This update provides advice on estimating the impairments based on the latest information for each bank as follows

- It is still estimated that the amount to be received in respect of Heritable Bank plc is 84.98%, but the repayment schedule has been amended to reflect repayments since Update 3.
- The bulletin recommends that the estimate of the recoverable amount for Kaupthing Singer & Friedlander Ltd should be based on a total repayment of 82%, increased from 71% in Update 3.
- Local authorities' priority status for the two Icelandic-domiciled banks has been confirmed by the courts, as has the position in relation to interest. Where deposits matured between 6 October 2008 and 22 April 2009, local authority claims should be on the value of the matured deposit plus the contractual rate of interest for the period from maturity to 22 April 2009.

# Guidance on 2010/11 accounts

CIPFA has issued *LAAP bulletin 88 Closure of the 2010/11 accounts and related matters* to provide further guidance on closing the 2010/11 accounts. The bulletin aims to provide sufficient information for authorities to identify issues they will need to address, and indicates where further guidance can be found. Auditors' attention is particular drawn to the issues referred to in the following paragraphs.

### Opening balance sheet

The bulletin clarifies that notes supporting the restated opening balance sheet are necessary and may require an additional comparative column in order to disclose the breakdown of balances at 1 April of the comparative year.

### Grants and contributions

The bulletin provides further guidance on the requirement in the *Code of practice on local authority accounting in the UK 2010/11* (the Code) that grants and contributions, including donated assets, should not be recognised until there is reasonable assurance that the authority will comply with the conditions attached to them. If there are no outstanding conditions, the grant should be credited directly to the CIES.

However, where a formal agreement states that a grant, contribution or donated asset must be returned if the stipulations attached to the agreement are not met, the accounting treatment is as follows

- Where there is no reasonable assurance that the conditions will be met, any cash received is a repayment due to the awarding body and should therefore be held on the balance sheet as a creditor.
- Where there is reasonable assurance that the conditions will be met, any cash received (or receivable) should be held on the balance sheet as grant receipt in advance. Once the conditions are satisfied, the grant should be credited to the CIES.

However, capital grants, contributions and donated assets that have been credited to the CIES are not proper credits to the general fund – see article on statutory guidance on capital grants and contributions.

**Cash and cash equivalents**

The bulletin also provides further guidance in regard to the Code's requirement that bank overdrafts that are repayable on demand and that are integral to an authority's cash management should be netted off the cash balance. This further guidance is necessary because the Code guidance notes offer the view that this treatment should not apply to liabilities recognised in relation to monies held on behalf of trust funds and common goods funds.

The bulletin states that, in Scotland, the nature of the arrangement between the trust fund/common good and the authority may be similar to an overdraft arrangement. Where this is the case, the liability should be netted off the cash balance. The materiality and volatility of balances, as well as the cash management policies of the authority, may be factors to consider when determining the appropriate accounting treatment.

**Trust funds**

The bulletin supports the TSU's view that, although the 2010/11 Code no longer contains a requirement to disclose details of the nature and amount of trust funds where the authority acts as the sole trustee, local authorities should continue to provide such disclosures. This disclosure is deemed to satisfy the requirements of section 106 of the *Local Government (Scotland) Act 1973* which applies the auditing requirements of that Act to charities where a local authority (or its members) is the sole trustee. This is because disclosure of this information allows the trust funds and common good to be audited as part of the audit of the accounts of the administering authority. Any failure by authorities to make these disclosures in their accounts would necessitate the preparation and audit of separate accounts for charities in order to satisfy the requirements of section 106.

**Disclosure on the impact of new accounting standards**

The bulletin refers to the Code's requirement for authorities to disclose information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted.

Disclosure will be required in 2010/11 in relation to the adoption of *FRS 30 Heritage assets*, and authorities are required to disclose the following to the extent that the information is known or reasonably estimable

- Narrative explaining that heritage assets are to be recognised as a separate class of assets for the first time in 2011/12.
- The carrying amount of assets expected to be reclassified as heritage assets, and their classification in 2010/11.
- The expected amount of any revaluation gains and losses to be recognised on reclassification.
- The expected change in depreciation and impairment to be recognised in 2010/11.

Where information is not available, this fact should be stated in the disclosure note. This should be accompanied by any information that can assist readers to understand the nature and extent of the financial impact of the adoption of the new standard.

**Pension fund financial statements**

The bulletin draws attention to the requirement for financial statements for the local government pension scheme (LGPS), and highlights the following points

- The regulations require an administering authority to prepare a governance compliance statement but allow the option of giving details of where the statement can be obtained rather than including it in the pension fund annual report. However, the bulletin strongly encourages authorities to include the governance compliance statement in the pension fund annual report. Failure to do so would require a statement on internal financial control (SIFC) covering the pension fund to be included in the annual report to ensure that minimum corporate governance reporting requirements are met. This is consistent with guidance already issued by the TSU. The administering authority annual governance statement/ SIFC should exclude the LGPS schemes.
- It would be helpful if the LGPS financial statements and notes submitted for audit included the governance compliance statement (or exceptionally SIFC).
- The LGPS financial statements are expected to conform to the Code requirements for an explanatory foreword, statement of responsibilities etc.

**Auditor action**

Auditors may find it useful to refer to this bulletin when checking authorities' compliance with the requirements of the 2010/11 Code.

## Guidance on group accounts

CIPFA has issued a revised *Group accounts in local authorities - a practitioners workbook* to help local authorities comply with the Code's requirements for group accounts where an authority has material interests in subsidiaries, associates and/or jointly controlled entities. This revised edition has been updated for international financial reporting standards and is intended to help authorities prepare a set of group accounts for the first time, or enhance the group accounts they currently publish. It contains guidance on the process, and provides illustrations and examples.

The workbook is available to inhouse auditors on the TSU intranet, and can be ordered from the CIPFA shop. Auditors' attention is particular drawn to the matters highlighted in the following paragraphs.

**Subsidiaries**

Subsidiaries are entities which the authority controls through the power to govern their financial and operating policies so as to obtain benefits from the entities' activities. The workbook therefore highlights that, in order for an organisation to be a subsidiary, it must qualify as an 'entity' for accounting purposes and it must be controlled by the authority

- The Code does not precisely specify what an entity is. Paragraph 37 of the workbook suggests that, in practical terms, an entity would need to be capable of being treated legally like a person (e.g. by entering into contracts in its own name, employing officers) and make binding decisions through its governing body.
- Control is defined in the Code as the power to govern the financial and operating policies of an entity, and paragraph 43 of the workbook suggests that the sort of policies that might be considered include
  - distribution or reinvestment of profits or surpluses
  - approval of the annual business plan
  - management of the entity's strategic direction, and the selection, termination and setting of remuneration of management
  - approval of capital expenditure, and raising of finance
  - winding up the entity.

The Code also requires that benefit should accrue to the authority as a result of governing the policies, and paragraph 45 of the workbook suggests that potential benefits could include: dividend payments; an interest in the residual net assets of the entity; and cost savings in procuring goods and services. It states that, in practice, it would be unusual for the test to be failed. It also highlights that the definition does not require the demonstration or exercise of control, but only the power to control.

Paragraphs 53 to 57 of the workbook consider SPEs and highlight that the operator of a PFI or PPP arrangement may be a SPE that requires consolidation. It lists a number of additional control tests that should be applied e.g.

- the activities of the SPE are being conducted on behalf of the authority according to its specific business needs
- the authority has the decision-making powers, or other rights, to obtain the majority of the benefits of the activities of the SPE
- the authority retains the majority of the residual or ownership risks related to the SPE.

**Associates**

The workbook highlights that, in order for an entity to be an associate, the authority must be an investor in the entity and have significant influence

- Investor relationships are not defined in the Code but paragraph 61 of the workbook draws attention to *IPSAS 7 Accounting for investments in associates* which specifies that a relevant investment in an associate is one that leads to the holding of an ownership interest in the form of a shareholding in a formal equity structure (or its equivalent). It should be noted that in the TSU's view this does not preclude the inclusion of police and fire joint boards as associates as a wider interpretation of 'investor' is appropriate in the public sector context.
- Significant influence is defined in the Code as the power to participate in the financial and operating policies of an entity. Paragraph 66 of the workbook highlights that significant influence does not require the demonstration or exercise of significant influence, but only the power to do so. Where an authority has an opportunity to take part in financial and operating decisions but does not do so, this is irrelevant to consideration as to whether there is an associate relationship.

In addition, paragraph 60 highlights that the definition of associate has been extended in the 2011/12 Code to include joint ventures where the authority does not share joint control but has significant influence.

**Group boundary and materiality**

The workbook states that the first step in establishing the boundaries of the local authority group is to identify all the bodies that are potentially under the control or influence of the authority. The next consideration is whether the inclusion of group accounts would make a material difference to the usefulness of the accounts for users. Paragraph 79 of the workbook states that authorities should presume that the Code's provisions require to be followed, unless it can be established that a different approach is appropriate. Paragraph 78 highlights that

- the focus of materiality is on the potential effect on users of the accounts

- potential omissions need to be considered collectively as well as individually
- qualitative factors can be as significant as quantitative factors.

Paragraph 90 of the workbook gives the following qualitative indicators of materiality

- The failure to consolidate group results would mask significant trends in the authority's overall financial performance or position, or strengthen or weaken unfairly the authority's standing.
- There are user expectations that would fail to be met if group information was not provided.
- The information concerns aspects of the authority's activity that have been identified as particularly significant in its strategic objectives.
- A full picture of the authority's arrangements for good corporate governance requires disclosures in relation to the group.

Paragraph 28 of the workbook addresses the inclusion of common good funds in group accounts. It states that consolidation may normally be expected to take the form of an adjustment to the single entity accounts.

**Aligning accounting policies**

The Code requires a common set of accounting policies to be applied in authority-only and group accounts. This means that the figures for group members will need to be aligned with the accounting policies adopted by the authority, to the extent that the adjustments would be material. Paragraph 111 considers the areas where consolidation adjustments are most likely e.g. cash equivalents, grants, property, plant and equipment, assets held for sale, leases, and employee benefits. No adjustments should be made to authority-only figures on consolidation into the group accounts in relation to accounting policies.

It is not expected that adjustments will be made for the statutory reversals that only authorities are permitted to make. Consequently, there should be no adjustments relating to group members in the line in the group movement in reserves statement for adjustments between the accounting basis and the funding basis.

Paragraph 82 makes the point that, in judging materiality, authorities need to consider the adjusted values in the accounts of the group members after their accounting policies have been aligned for consolidation.

**Group financial statements**

Where required, authorities are required to prepare accounts for the authority-only and for the group. However, the Code allows these two separate sets of accounts to be presented alongside each other in a columnar approach and paragraph 192 of the workbook recommends this approach.

Paragraph 200 provides an illustration of a group movement in reserves statement.  The structural differences between the authority-only and the group statement are

- new columns for the authority's share of the reserves of subsidiaries, associates and joint ventures and for total reserves for the group
- new lines for adjustments between group accounts and authority accounts and for net increase/decrease before transfers.

Paragraph 206 provides an illustration of a group CIES.  The structural differences between the authority-only and the group statement are

- new lines after the surplus or deficit on the provision of services for associates and joint ventures accounted for on an equity basis and tax expenses
- a new line in the other comprehensive income and expenditure section for the share of other comprehensive income and expenditure of associates and joint ventures.

Paragraph 213 provides an illustration of a group balance sheet.  The structural differences between the authority-only and the group statement are

- new lines for
  - investments in associates and joint ventures.  In the authority-only balance sheet, these amounts will be under the general investments heading, but they are separated out in the group balance sheet as the balances are converted from fair value or cost less impairment to the equity basis
  - liabilities in associates where an authority has negative balances in respect of individual associates
  - corporation tax liabilities.
- expanded content for the intangible assets line to include any goodwill
- expanded content for the usable reserves and unusable reserves lines
  - Usable reserves will largely be restricted to the profit and loss reserve.
  - Unusable reserves will include the revaluation reserve, the share premium account and minority interests.

**Segment reporting**

Paragraph 231 of the workbook covers preparing the group note on segment reporting.  The figures in the authority-only and the other entity accounts should not be consolidated.  Instead, a new note should be compiled, working from the viewpoint of the chief operating decision maker of the authority

- Where the results of group members are presented as discrete internal management reports to the chief operating decision maker, these segments should be added to the list of reportable segments relating to the authority's own activity and the relevant figures consolidated into the reconciliations accompanying the segmental disclosure.
- Where the results of group members are not reported, the group members' results are not reportable segments and should instead be consolidated into the note as adjusting items in the reconciliations.

**Documentation of decisions**

Paragraphs 234 to 237 cover the requirement for authorities to document the decisions they take in relation to accounting for the group. Such decisions should be reviewed by the responsible financial officer as part of their preparations for certifying the accounts and evidence of this review should be retained. The most significant decisions that would benefit from documentation are considered to be

- the initial exercise of identifying which relationships with other bodies need to be considered
- how each of the relationships identified has been classified as subsidiaries, associates, joint ventures or simple investments
- decisions about materiality
- the accounting policies that need to be adjusted and the process for making the adjustments
- the consolidation adjustments required and how they are to be calculated and processed.

Documentation should set out the main arguments for and against a particular treatment where significant decisions are required and explain how the final conclusion was reached.

**Auditor action**

Auditors may find it useful to refer to this workbook when confirming that authorities have properly accounted for group accounts.

## Statutory guidance on capital grants and contributions

The Scottish Government has issued *Finance circular 6/2011 Accounting for grants contributions and donated assets* which contains statutory guidance on the accounting requirements for grants and contributions for capital expenditure, and for donated assets, from 2010/11.

From 2010/11, the Code requires grants and contributions for capital purposes, and donated assets, to be recognised as income immediately in the CIES if all conditions are met and receipt is reasonably assured. However, this income is not a proper credit to the general fund and therefore the guidance sets out the following treatment

- Where a capital grant or contribution has been recognised in the CIES, and the expenditure has been incurred at the balance sheet date, the grant or contribution requires to be transferred from the general fund to the capital adjustment account.
- Where the expenditure has not been incurred, the grant or contribution requires to be transferred from the general fund to the capital grants unapplied account. When the expenditure is subsequently incurred, the grant or contribution is then transferred to the capital adjustment account.
- Where a donated asset has been recognised in the CIES, the income requires to be transferred from the general fund to the capital adjustment account.

This guidance also makes conforming changes to *Finance circular 4/2010 Accounting for PFI and similar arrangements* in respect of donated assets. In addition, it also adds clarification to that guidance in respect of the statutory charge for lifecycle replacements.

Auditors should confirm that authorities comply with this guidance.

## Statutory guidance on investment properties

The Scottish Government has issued *Finance circular 7/2011 Accounting for investment properties* to clarify the accounting requirements for investment properties from 2010/11. It clarifies that a gain or loss arising from derecognition or a change in the fair value of investment property, or any impairment, are not proper charges to the general fund. The guidance requires

- the gain or loss from a change in the fair value to be transferred from the general fund to the capital adjustment account
- disposal proceeds (net of any disposal costs) on derecognition to be treated as a capital receipt, and the carrying amount to be charged to the capital adjustment account
- impairment, and any compensation from third parties, to be transferred from the general fund to the capital adjustment account.

Auditors should confirm that authorities comply with this guidance.

# Other developments

The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.

## Remuneration reports

### New guidance

The Scottish Government has issued *Finance circular 8/2011 Local authority accounts – the remuneration report*, and a subsequent clarifying email, which contain guidance to assist local authorities in implementing the requirement for a remuneration report from 2010/11 (see TB 2011/1 – page 38). The circular was originally issued in April and subsequently re-issued in May with revised guidance. The circular

- states that the remuneration report is a statement in its own right, rather than a note to the accounts, and suggests that it should appear after the annual governance statement
- provides a number of sample disclosures
- clarifies that disclosures should be on an accruals basis and reflect IAS 19 requirements as set out in the Code, and statutory adjustments should be ignored
- recommends that the report should be approved and signed by the chief executive and a leading member
- requires that authorities clearly identify those parts of the remuneration report that are subject to audit.

Disclosures should include any senior councillor or senior employee who leaves during the year and the guidance clarifies the following points

- The actual remuneration should be reported but the guidance suggests that a full year equivalent, together with their leaving date, should also be disclosed. Any replacement will also need to be disclosed.
- If a senior employee changes posts during the year, there should only be one disclosure for that person but it should reflect the change of post.
- Where an employee is promoted into a senior employee post from a position that does not require disclosure, only the remuneration which relates to their new appointment is to be disclosed, with no prior year comparator information.

Where a contractual confidentiality agreement was agreed prior to 7 February 2011 that binds an authority to not disclose publicly the terms on which it remunerates a person, it is not required to disclose remuneration details for 2010/11 or previous years. However, the circular requires a note to be included that explains that the data is not being disclosed due to a contractual agreement in place.

Relevant persons for whom remuneration disclosures are required include any employee (including those of a subsidiary) whose annual remuneration is £150,000 or more. The circular advises that, when determining the remuneration of part time employees or any employed for only part of the year, the salary element is required to be calculated as if that person worked full time or for the whole year. However, the amount to be disclosed should be the actual value of their remuneration.

The circular (and note for guidance 2011/6[LA]) includes the chief education officer appointed under the *Education Act 1996* as a relevant person by virtue of being a statutory officer. It should be noted, however, that this does not apply in Scotland. The Scottish Government's subsequent email advises that, while the specific disclosure itself does not apply, where an authority has an education officer who meets the wider definition of 'senior employee', disclosure would still be required.

Bonuses is one of the specified categories of remuneration that requires to be disclosed. The circular states that bonuses should relate to the performance of senior employees in the year in which they become payable. However, if the appraisal process does not allow sufficient time to accrue for individual bonuses relating to 2010/11 performance in that year's financial statements, the guidance allows bonuses based on 2009/10 performance (with comparative bonuses based on 2008/09 performance) to be disclosed, with a note explaining this treatment. The bonus disclosure should only include non-consolidated payments, i.e. a payment that does not permanently increase the salary of the individual. Consolidated performance pay in contrast should be disclosed as part of salary rather than bonuses.

A further specified category is compensation for loss of employment, and the circular clarifies that this should include lump sum and annual compensation payments for premature retirement and redundancy payable under the relevant regulations. However, the guidance requires the annual compensation amounts to be disclosed separately, with an explanatory note, and not included in the total remuneration amounts.

Where senior employees act for other authorities or joint boards, each case is considered individually as follows

- If the employee holds the position solely by virtue of their main employment, and is remunerated by their employing authority, any remuneration should be included in their total remuneration.
- Where the employee has an independent contract with, and is paid by, the other authority, the payment does not form part of their remuneration that requires to be disclosed by the main employing authority.

The guidance states that the Convenor and Vice-Convenor of joint boards should be treated as senior councillors for the purposes of remuneration report disclosures. Where a Convenor or Vice-Convenor is also senior councillor, the remuneration disclosures should identify that additional responsibility, including the name of any joint board.

The remuneration paid to councillors by a subsidiary should be disclosed in the table for subsidiaries. Where a councillor is also a senior councillor, a note to the senior councillor disclosure should identify the additional remuneration paid by the subsidiary.

The accrued pension benefit should reflect both the employer and employee/councillor contributions made to a person's pension. Only additional voluntary contributions to their pension are to be excluded. The email clarifies that the rate to be used in calculating the employer contribution should be the adjusted rate as specified in the rates and adjustments certificate. In addition, the accrued pension benefit should reflect any transfer of pension benefits from another pension fund. The original circular advised that the contribution disclosures should include any contributions which the employee was required to make. The revised circular corrects this advice and clarifies that no employee contributions should be included.

The sample disclosure at paragraph 62 of the circular includes text which advises that there is no entitlement to a lump sum for the LGPS. The subsequent email clarifies that this applies only to the current LGPS, and that a lump sum may still be payable to those with service under the old scheme, in which case disclosure would be required.

If a senior councillor has pension benefits arising from their association with a subsidiary, that councillor's combined pension benefit should be disclosed in the senior councillor pension table, with a disclosure note advising of the additional pension benefits. Where they are not senior councillors, it should be disclosed in the subsidiaries table.

Auditors should use this guidance when checking authorities are complying with the requirement for a remuneration report from 2010/11.

# Pension funds

## Governance compliance statement guidance

The Scottish Ministers has issued *Local government pension scheme circular 3/2011 LGPS governance guidance* to provide guidance on the compliance standards against which LGPS administering authorities are to measure their governance arrangements from 2010/11.

The guidance includes a combination of narrative explaining the rationale of each compliance principle, and also a description of the relevant statutory provision of *The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008*, which requires LGPS administering authorities to measure their governance arrangements against the standards set out in this guidance.

Where compliance does not meet the published standard, there is a requirement under the regulations for administering authorities to set out any reasons for non-compliance in their governance compliance statement.

Auditors should review the governance compliance statement to check whether it complies with the guidance and report where it does not.

## Benefits

### 2010/11 HB COUNT module 5

The Audit Commission has issued module 5 of the 2010/11 HB COUNT approach to the audit of benefit subsidy claims. Module 5 provides the software diagnostic tool component of HB COUNT. The aim of this module is to ensure that benefits subsidy claims have been completed using the recognised software version and standard year end claim completion program issued by the software supplier. It seeks to confirm that the benefits system has been internally balanced in terms of benefit 'granted' and benefit 'paid' using the software supplier's standard methodology.

The module contains a control matrix for each supplier at appendix 1 that requires to be completed by auditors. The non-compliance data return at appendix 2 should be submitted to Owen Smith in the TSU (and not HB leads as stated in the module).

# Legislation

The following items of legislation can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.

## Statutory instruments

### Local government

*The Local Government Finance (Scotland) Amendment Order 2011, SSI 218* came into force on 3 March 2011 and amended *The Local Government Finance (Scotland) Order 2011* in respect of revenue support grant and non-domestic rate income for 2011/12.

*The Local Government Finance (Scotland) Amendment (No 2) Order 2011, SSI 219* came into force on 12 March 2011 and further amended the *Local Government Finance (Scotland) Order 2011* in respect of non-domestic rate income for 2011/12.

*The Local Governance (Scotland) Act 2004 (Remuneration) Amendment Regulations 2011, SSI 264* come into force on 1 July 2011 and amend the principal 2007 Regulations in relation to councillor remuneration. The amendment prohibits local authorities from allowing any body they control from making payments to councillors by way of remuneration, other than reimbursement of expenses.

# Key circulars

The following circulars can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.

## Finance circulars

*Finance circular 5/2011 Accounting for investments – Icelandic banks.* See Accounting developments – Guidance on impairing deposits in Icelandic banks – New statutory guidance.

*Finance circular 6/2011 Accounting for grants contributions and donated assets*. See Accounting developments – Statutory guidance on capital grants and contributions.

*Finance circular 4/2010 Accounting for PFI and similar arrangements (as amended by 6/2011).* See Accounting developments – Statutory guidance on capital grants and contributions.

*Finance circular 7/2011 Accounting for investment properties.* See Accounting developments – Statutory guidance on investment properties.

*Finance circular 8/2011 Local authority accounts – the remuneration report.* See Other developments – Remuneration reports – New guidance.

## Pension circulars

### Local government

*Local government pension scheme circular 3/2011 LGPS governance guidance.* See Other developments – Pension funds – Governance compliance statement guidance.

### Police

*Police pension scheme circular 2/2011 Police pension scheme – Revised commutation factors* and accompanying guidance advises on revised commutation factors from 20 April 2011 for the purpose of calculating lump sums payable under *The Police Pension Regulations 1987*.

# Publications

## Audit Scotland

### Arm's-length external organisations (ALEOs): are you getting it right?

This publication *Arm's-length external organisations (ALEOs): are you getting it right?* is designed to promote and encourage good practice in the way arm's-length external organisations (ALEOs) are set up and operated.  Councils use ALEOs to deliver a wide range of activities such as leisure services, economic development and property maintenance.  The publication focuses on how councils establish ALEOs and maintain governance and accountability for both finance and performance.  It highlights areas that work well and where improvement may be required.  Key messages include the following

- While the ALEO takes on responsibility for service delivery, the council remains responsible for ensuring that the ALEO uses the public funds the council provides properly and can demonstrate best value.
- The 'following the public pound' principles continue to provide the basis for sound governance of ALEOs.
- Any decisions to use an ALEO to deliver services should involve an appraisal of the options available and a sound business case, using expert advice when necessary.  Councils should periodically review their ALEOs to ensure they remain the best option for service delivery, and to ensure effective governance is in place.
- Councils need good-quality monitoring information so they are aware of the ALEOs' finances, risks and performance.  Monitoring should be risk-based and proportionate.
- Ongoing training and guidance should be provided so that councillors and officers involved in any capacity with ALEOs have the skills they need to undertake their duties.

## Accounting

### Code of practice on local authority accounting in the UK – disclosure checklist for 2010/11

This checklist from CIPFA is on the disclosure requirements of the 2010/11 Code.  It is intended to be an aide-memoire for local authorities and auditors to ensure the Code's disclosure requirements are met.  If the answer to a question is no, a justification for departing from the Code should be given and, where the impact is material, disclosed in the accounts.

It is available to inhouse auditors on the TSU intranet, and can be ordered from the CIPFA shop.

### IFRS: how to tell the story

This briefing note from CIPFA *IFRS: how to tell the story* is intended to help local authority officers present financial statements based on international financial reporting standards for 2010/11 to members and other key stakeholders.  It provides an overview of the main changes involved and explains how the new formats can be used to convey key information in

- comparisons with budgets

- general fund and HRA performance
- reserves position
- cash flows.

It can be obtained by using the hyperlink, and is available to inhouse auditors on the TSU intranet.

## Auditor action

The following is a summary of items in this chapter of the TB that recommend that auditors take certain actions

| Section | Action |
|---|---|
| Accounting developments – Guidance on moving from RPI to CPI for retirement benefits - | Auditors may find it useful to refer to the LAAP bulletin when confirming that authorities have properly accounted for the change from RPI to CPI. |
| Accounting developments – Guidance on impairing deposits in Icelandic banks – New statutory guidance | Auditors should confirm that authorities comply with the statutory guidance on impairing deposits in Icelandic banks where they choose to apply it. |
| Accounting developments – Guidance on 2010/11 accounts | Auditors may find it useful to refer to the LAAP bulletin when checking authorities' compliance with the requirements of the 2010/11 Code. |
| Accounting developments – Guidance on group accounts | Auditors may find it useful to refer to the CIPFA workbook when confirming that authorities have properly accounted for group accounts. |
| Accounting developments – Statutory guidance on capital grants and contributions | Auditors should confirm that authorities comply with the statutory guidance on capital grants and contributions. |
| Accounting developments – Statutory guidance on investment properties | Auditors should confirm that authorities comply with the statutory guidance on investment properties. |
| Other developments – Remuneration reports – New guidance | Auditors should use the Scottish Government guidance when checking authorities are complying with the requirement for a remuneration report from 2010/11. |
| Other developments – Pension funds – Governance compliance statement guidance | Auditors should review the governance compliance statement to check whether it complies with the guidance and report where it does not. |

# Health chapter

## Introduction

This chapter contains articles on health technical developments and guidance relevant to external auditors' responsibilities under their audit appointment to give an opinion on the financial statements. It should be read by external auditors with appointments in the health sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance and urgent issue notes).

The articles in this TB are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to inhouse auditors from the TSU intranet.

In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note the following articles in this chapter are of relevance to 2010/11 audits

- note for guidance on auditing 2010/11 health annual accounts
- disclosure of exit packages and senior staff bonuses
- 2010/11 executive and senior managers remuneration
- GP access survey.

There are also articles in this chapter on the following subjects: 2011/12 pay uplifts; VAT reimbursement changes; 2011/12 enhanced service arrangements; 2011/12 chronic medication service; 2011/12 recruitment and retention premia; and 2011/12 minor ailments service.

## TSU developments

### Publications

The following note has been published by the TSU since TB 2011/1. It can be obtained by using the hyperlinks, and is available to inhouse auditors from the TSU intranet.

## Note for guidance on auditing 2010/11 health annual accounts

The TSU has published *Note for guidance 2011/4(H) 2010/11 health annual accounts* to provide auditors with guidance on auditing the 2010/11 annual accounts.

# Accounting developments

The document referred to in the following article is available to inhouse auditors from the TSU intranet and has been emailed to the firms.

## Guidance on disclosing exit packages and senior staff bonuses

The Scottish Government Health Directorate (SGHD) has issued guidance on the requirement to disclose senior staff bonuses and information on exit packages in the 2010/11 annual accounts (see TB 2011/1 – page 50).

The guidance advises that an additional column should be added to the table in the remuneration report, for both the current and prior year, in respect of performance related bonus. The bonus disclosed should relate to the year in which it becomes payable, but the guidance clarifies the following in respect of bonuses

- There should be no non-consolidated performance payments for 2008/09 or 2009/10. The guidance requires a footnote to be disclosed to explain the position and provides some suggested wording.
- Discretionary points and distinction awards given to some executive board members are considered to be part of salary rather than a bonus. A footnote where senior staff receive such remuneration may be appropriate.
- Consolidated pay progression based on performance in the previous year is a salary uplift and should be included in the salary column.

It is therefore anticipated that the performance related bonus column should disclose zero for all executive board members.

Boards are required to disclose information on the number and cost of exit packages at note 32, split between compulsory redundancies and the number of other departures agreed, along with comparatives. Other departures include all cases where compensation has been paid, including dismissals on the grounds of inefficiency, early retirement and voluntary exit schemes. Where there has been a material scheme in year, boards are required to include a footnote detailing the scheme. It is not anticipated that there should be any compulsory redundancies to be disclosed in 2010/11. A revised template for note 32 is attached to the guidance.

The TSU has clarified that the SGHD expects the total resource cost of exit packages to be stated on an accruals basis and reflect the full cost of the exit package to be met by the board.

Auditors should confirm that their boards are aware of this guidance and consider the implications for the audit of the 2010/11 annual accounts.

# Other developments

The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors from the TSU intranet.

## Pay modernisation and workforce planning

### 2011/12 pay uplift for agenda for change staff

*PCS(AFC)(2011)5* informs boards of the following changes in the pay and conditions of staff covered by *Agenda for change* which apply from 1 April 2011

- Staff currently earning under £21,000 (i.e. those on pay points 1 to 15) receive a whole time equivalent flat rate increase of £250.
- As part of the multi-year deal agreed in 2008, the value of point 23 has been increased by 0.33%.
- Pay point 1 must not be used as it falls below the Scottish living wage.

### 2010/11 executive and senior managers' remuneration

Minor amendments in respect of the mandatory executive and senior management pay arrangements for 2010/11 have been announced in *CEL(2011)7*. The consolidated pay progression increases are being applied from 1 October 2010 based on performance in 2009/10. The increases based on individual manager performance marking are

- nil for an unacceptable or incomplete marking
- 0.5% for a fully acceptable marking
- 1% for a superior or outstanding marking.

No employee will receive more than the maximum consolidated salary for their pay range.

Employees on personal protection who are at their maximum personal salary are not eligible for a consolidated uplift from 1 October 2010. Those on protection who are not at their maximum will not have their maximum increased from that date.

There is no change to the pay ranges for grades A to I and no provision for non consolidated performance payments in respect of the performance year 2009/10.

## 2011/12 pay uplift for hospital and community medical and dental staff

The pay rates for hospital and community medical and dental staff for 2011/12 have been announced in *PCS(DD)(2011)2*. Pay and associated allowances will remain at current levels except for those earning £21,000 or less, but incremental progression will continue to apply for those eligible. The circular also includes revised progression tables for those covered by the 2004 consultant contract.

There will be no increase in the value of distinction awards, no new awards and no progression through the award scheme during 2011/12. Discretionary points will be paid in 2011/12 in respect of work done in 2010/11, and work undertaken from 1 April 2011 onwards should not count towards discretionary points.

## 2011/12 pharmacy remuneration arrangements

*PCA(P)(2011)4* advises boards of remuneration and reimbursement arrangements for community pharmacy contractors for 2011/12. The transitional payment regime is being rolled forward with the global sum and temporary support package maintained at the 2010/11 level. However, changes to the arrangements for 2011/12 include

- the terms of the efficient purchasing and prescribing programme (ePPP) being updated to reflect a target efficiency saving
- the part 11 reimbursement clawback rate reducing from 6.33% to 6.11%
- the clawback rate for Pt 7 items being re-set to zero as a consequence of the revised ePPP.

## VAT reimbursement changes

*PCA(M)(2011)6* provides advance notice of an amendment to the reimbursement of VAT to be included in the statement of financial entitlements (SFE) for GMS contractors from 1 July 2011.

Dispensing GP practices will no longer be reimbursed their VAT costs on dispensed drugs and appliances, outwith a limited list of exemptions. As a transitional arrangement, boards may agree to temporarily continue the VAT reimbursement arrangements in respect of any practices where the requirement to dispense will be time limited e.g. where a pharmacy will shortly be opened. This amendment will bring arrangements for Scottish practices into line with existing provisions in England and Wales.

The letter advises practices to consider voluntarily registering for VAT so that they may be eligible for recovery in the normal way. A one off VAT registration support payment of £3000 will be paid to all dispensing practices not registered for VAT at 1 April 2011.

## 2010/11 enhanced service arrangements

The SGHD issued the following three letters setting out the enhanced service arrangements for 2011/12

- *PCA(M)(2011)5* announces minor amendments to the directed enhanced services (DES) programme including changes to the osteoporosis DES and the discontinuation of the ethnicity monitoring and interpreter needs DES.
- *PCA(M)(2011)8* provides further detail on the arrangements for the osteoporosis DES. Practices participating for the first time in the DES will be eligible for a one-off engagement payment of £110. An achievement payment based on the number of relevant patients included on the practice list will also be payable.
- *PCA(M)(2011)10* confirms the funding arrangements for the continuation of the Scottish enhanced services programme. For 2011/12, boards will receive the same allocation as they received in 2010/11. The use of enhanced services is currently under review and boards are advised to consider this when entering into commitments beyond 1 April 2012.

## 2010/11 GP access survey

Scotland's Chief Statistician has issued *GP access survey results 2011* which announces the results from the 2010/11 GP access survey. The survey was carried out by the Scottish Government with the purpose of measuring the quality and outcomes framework (QOF) indicators for patient experience of access. The survey was sent to a random sample of patients registered with 161 GP practices in Scotland that opted into the survey. The main findings are

- 94.3% of patients were able to see or speak to someone at their practice within 48 hours (94.5% last year).
- 85.2% were able to book appointments in advance (84.5% last year).

These results inform two indicators in the QOF. For both indicators, practices with 90% or more of patients answering positively will achieve full points. For the indicator related to 48 hour access, no points are awarded for 70% or less, and for the indicator related to advance booking of an appointment, no points are awarded for 60% or less.

Practices that did not participate in the survey will receive the same access points as in 2009/10.

## 2011/12 recruitment and retention premia

*PCS(AFC)(2011)6* announces the withdrawal of national recruitment and retention premia (NRRP) from 1 April 2011

NRRP should not be paid to new starters from that date. Transitional arrangements for staff currently in receipt of the payments involve full payment in 2011/12, reducing to 50% in 2012/13, and no payments after 1 April 2013.

# Family health service

## Abolition of prescription charges

The SGHD has advised of the abolition of prescription charges in Scotland from 1 April 2011 in *PCA(M)(2011)7*. From that date, there are no charges for Scottish NHS prescription forms presented for dispensing in Scotland (or Wales and Northern Ireland), or prescription forms from Wales and Northern Ireland presented in Scotland.

Prescription forms from England, and Scottish prescription forms presented for dispensing in England, will be charged at the new rate of £7.40 per item, unless the patients are exempt. Patients resident in Scotland and registered with a GP in England will require a valid entitlement card to obtain free prescriptions when dispensed at a pharmacy in Scotland.

Where an overseas visitor is deemed eligible to access NHS services and is provided with a Scottish prescription form they will be entitled to have the prescription dispensed free of charge if presented in a pharmacy in Scotland.

Medical and maternity exemptions will remain and certificates will be required to verify a patient's entitlement to register for the minor ailment service (MAS) and for entitlement to exemption if a prescription is dispensed in England. There is no change to MAS as a result of the abolition of prescription charges and the same groups of patients will continue to be eligible for the service.

The current prescription stationery will remain in circulation. However the patient declaration is being revised and the revised stationery will be phased in as current stocks are used up.

## 2011/12 chronic medication service

*PCA(P)(2011)8* encloses updated directions for the chronic medication service (CMS) from 16 May 2011. The directions provide the legal framework for CMS, set out the eligibility criteria for CMS registrations, and provide the terms and conditions to be followed by those delivering the service. They have been updated to

- remove the restriction on who can receive a serial prescription
- remove the limit of 50 patients per pharmacy
- update the definition of a care home.

### 2011/12 minor ailments service

[PCA(P)(2011)6](PCA(P)(2011)6) provides revised directions and service specification for the MAS from 1 April 2011. There are no changes to who is eligible to register for MAS, and there are no plans to extend MAS to all patient groups.

## Key circulars

The following circulars can be obtained by using the hyperlinks, and are available to inhouse auditors from the TSU intranet.

## Chief executive letters (CEL)

CEL(2011)7 *Pay and conditions of service executive and senior management pay 2010/11*. See Other developments – Pay modernisation and workforce planning – 2010/11 executive and senior managers remuneration.

## PCA

PCA(P)(2011)4 *Community pharmacy services – Drug tariff remuneration and part 7 and part 11 reimbursement arrangements for 2011/12.* See Other developments – Pay modernisation and workforce planning – 2011/12 pharmacy remuneration arrangements.

PCA(P)(2011)6 *Additional pharmaceutical services – minor ailment service directions and service specifications.* See Other developments – Family health services – 2011/12 minor ailment service.

PCA(P)(2011)8 *Additional pharmaceutical services chronic medication service – updated directions.* See Other developments – Family health services – 2011/12 chronic medication service.

PCA(M)(2011)5 *The Primary Medical Services (Directed Enhanced Services)(Scotland) Directions 2011.* See Other developments – Pay modernisation and workforce planning – 2011/12 enhanced service arrangements.

PCA(M)(2011)6 *General medical services statement of financial entitlements for 2011/12– advance notice of withdrawal of concession on reimbursement of VAT*. See Other developments – Pay modernisation and workforce planning – VAT reimbursement changes.

PCA(M)(2011)7 *The National Health Service(Free Prescriptions and Charges for Drugs and Appliances)(Scotland) Regulations 2011*. See Other developments – Family health services – Abolition of prescription charges.

*PCA(M)(2011)8 Osteoporosis (Scotland) directed enhanced service 2011/12.* See Other developments – Pay modernisation and workforce planning – 2011/12 enhanced service arrangements.

*PCA(M)(2011)10 Primary Medical Services: Scottish enhanced services programme (SESP) 2011/12.* See Other developments – Pay modernisation and workforce planning – 2011/12 enhanced service arrangements.

## PCS

*PCS(AFC)(2011)5 Pay and conditions for NHS staff covered by the agenda for change agreement.* See Other developments – Pay modernisation and workforce planning – 2011/12 pay uplift for agenda for change staff.

*PCS(AFC)(2011)6 Changes to NHS terms and conditions handbook: section 5 and annex R – national recruitment and retention premia.* See Other developments – Pay modernisation and workforce planning – 2011/12 recruitment and retention premia.

*PCS(DD)(2011)2 All hospital medical and dental staff and doctors and dentists in public health medicine and the community health service and consultants covered by the 2004 consultant contract - pay for 2011/12.* See Other developments – Pay modernisation and workforce planning – 2011/12 pay uplift for hospital and community medical and dental staff.

# Publications

The following publications can be obtained by using the hyperlinks.

## Audit Scotland

### Review of community health partnerships

This report *Review of community health partnerships* examines whether community health partnerships (CHPs) are achieving the objectives of moving care from hospitals into the community and improving the health and quality of life of local people. Key messages include the following

- Many CHPs were set up in addition to existing partnership arrangements, and cluttered arrangements have led to duplication and a lack of clarity. A fundamental review of the various partnership arrangements should be undertaken to ensure that they are efficient and effective
- Few CHPs have been able to influence how resources are used across the whole system. At a CHP level, information on resources is not well developed, and there are significant gaps in the information available. Boards and councils should collect, monitor and report data on staff, activity and costs and improve CHP financial management and reporting information.

- GPs and clinical professionals are not yet fully involved in service planning and resource allocation.

A checklist has been developed to assist councils and boards improve the joined up approach to services.

## Performance management

### Managing high value capital equipment in the NHS in England

This report *Managing high value capital equipment in the NHS in England* from the National Audit Office (NAO) examines how efficiently high value medical equipment is managed in the NHS in England. Key findings include the following

- Trusts now take financing decisions and make their own assessments of demand largely independently of each other. There is more scope for trusts to act together to achieve greater savings and efficiencies by planning in the light of the capacity required. GP consortia should work together to assess levels of demand across a wider locality.
- Trusts should assess the costs and benefits of purchasing, leasing and outsourcing when replacing machines, and check for alignment with planned levels of activity.
- The workforce to support delivery of services has shortfalls and there are wide variations in opening hours and waiting times, unit costs and utilisation rates. There are opportunities to improve the efficiency of the operation of machines by assessing the design of the patient pathway.
- Trusts lack accurate information on unit costs, utilisation rates and maintenance costs. The NHS Commissioning Board should set standards for accurate and comparable data and design tariff prices in a way that incentivises the efficient use of machines. Trusts should participate in benchmarking and look for opportunities to group their demand for machines with other trusts to secure savings on the price of machines.

### Reducing expenditure on low clinical value treatments

This briefing from the Audit Commission *Reducing expenditure on low clinical value treatments* looks at the approach trusts in England are taking to treatments that are clinically ineffective or not cost effective. Most trusts are planning to identify such treatments with the aim of freeing up money to invest in services with better clinical outcomes. However, there is no national list of low clinical value treatments and trusts have been developing their own lists and approaches.

The Audit Commission estimates that significant savings are achievable, and has developed a tool to help trusts identify the potential reduction in spend.

## The national programme for IT in the NHS – an update on the delivery of detailed care records systems

This report *The national programme for IT in the NHS* from the NAO provides an update on the delivery of detailed care records systems in England. Key findings include the following

- Delivery of the contracted number of systems continues to fall below expectations and fewer systems will now be delivered, although the cost of delivering systems remains substantially the same. These reductions mean that the aim of creating an electronic record for every NHS patient will not be achieved.
- There is also an increased risk of not achieving adequate compatibility across the NHS to effectively support joined up healthcare. Care records systems require further development to reach the contracted level of functionality.

# Auditor action

The following is a summary of items in this chapter of the TB that recommend that auditors take certain actions

| **Section** | **Action** |
|---|---|
| Accounting developments – Disclosure of exit packages and staff bonuses | Auditors should confirm that their boards are aware of the SGHD guidance and consider the implications for the audit of the 2010/11 annual accounts. |

# Central government chapter

## Introduction

This chapter contains articles on central government technical developments and guidance relevant to external auditors' responsibilities under their audit appointment to give an opinion on the financial statements. It should be read by external auditors with appointments in the central government sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance and urgent issue notes).

The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to inhouse auditors on the TSU intranet.

Auditors may wish to note that the following articles in this chapter relate to 2010/11 audits

- note for guidance on auditing the 2010/11 whole of government accounts
- TSU guidance on remuneration reports, and the removal of cost of capital charge
- guidance on 2010/11 remuneration reports
- guidance on 2010/11 whole of government accounts
- 2010/11 disclosure checklist.

There are also articles on proposed amendments to the 2011/12 general provisions discount rate, and changes to the SPFM section on grants and grant-in-aid.

## TSU developments

### Publications

#### Note for guidance on auditing 2010/11 whole of government accounts returns

The TSU will shortly be publishing *Note for guidance 2011/7(CG) 2010/11 whole of government accounts* to provide auditors with guidance on auditing the 2010/11 whole of government accounts (WGA) submissions of central government bodies.

## Responses to enquiries

The TSU operates a ‘help-desk’ for auditors which provides responses to ad hoc technical enquiries. Selected responses are added to the frequently asked questions section of the TSU intranet and include the following since the publication of TB 2011/1.

### Remuneration reports

***Should salary and allowances disclosed in the remuneration report include employers’ pension contributions?***

The *2010/11 Government financial reporting manual* (the FReM) requires the preparation of a remuneration report as set out in the *Companies Act 2006*. The Act requires remuneration reports to be prepared in accordance with *The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008*. Paragraph 17(1) of Schedule 8 to the Regulations specifically excludes employer contributions from being included as remuneration.

Employer contributions should not therefore be included in salaries and allowances. This guidance supersedes paragraph 165 of note for guidance 2011/2(CG). However, employer contributions should be included in the calculation of pension benefit.

## Other guidance

### Removal of cost of capital

TB 2010/4 (page 46) provided guidance in respect of the removal from 2010/11 of the FReM requirement for bodies to charge a notional cost of capital, and advised that it should be treated as a change in accounting policy.

Normally, a change in accounting policy would require a restated opening balance sheet. However, in the TSU’s view, this is not necessary in this case as no balance sheet items are affected. Instead, a note explaining the change of policy, stating that it had no effect on the balance sheets for any period, and describing the impact of the change on the statement of comprehensive net expenditure would be sufficient.

# Accounting developments

The document referred to in the following article can be obtained by using the hyperlink, and is available to auditors on the TSU intranet.

## Guidance on 2010/11 remuneration reports

The Cabinet Office has issued *EPN 296 Disclosure of salary, pension and compensation information for 2010/11* which provides guidance on the preparation of a remuneration report for 2010/11. Remuneration reports contain information about the pay and pension packages of Ministers and the senior management team. They should include information about remuneration policy and the individual's contract of employment. As well as salary and pension information, they should also include detailed information about compensation paid to senior management.

There are two main changes to the requirements from last year

- Bonuses paid should be reported separately from salaries.
- Summary data on exit packages awarded to all staff should be disclosed. Disclosure includes the number of exit packages by cost band, broken down by the number of compulsory redundancies and the number of other departures agreed. Comparative data should be provided for 2009/10.

In addition, the actuarial factors used in the calculation of cash equivalent transfer values mean that the values shown for 31 March 2010 will not be the same as the corresponding figure shown in the 2009/10 report. Bodies are required to add a footnote to explain this.

An example remuneration report, including exit packages disclosures, is provided at Annex 13C.

## Proposed amendments to general provisions discount rate

HM Treasury has issued *Exposure draft (11)01 Proposals to improve the methodology for setting the general provisions discount rate* which proposes amendments to the 2011/12 FReM in respect of setting the discount rate for general provisions.

*IAS 37 Provisions, contingent liabilities and contingent assets* requires a provision to be stated at its present value where the effect of the time value of money is material. The FReM interprets IAS 37 by requiring bodies to use the discount rate set by HM Treasury. Under the current methodology, before each spending review period, Treasury sets one real discount rate determined with reference to the real return of index-linked Gilts. There are however aspects of this methodology which do not represent full compliance with IAS 37. The proposed amendments are in respect of the following issues

- Rather than setting one real discount rate to be applied by all entities to all provisions, the option is suggested of Treasury providing a full range of nominal and real discount rates along with market expectations of future inflation. Entities would then be able to choose the rate(s) which most closely corresponds to a specific provision or liability.

- The inflation rate used to ascertain the real rate has been the government’s target rate of inflation. It is proposed that a revised methodology should be introduced to ensure discount rate reflect rates of inflation derived from market expectations.

- It is proposed that the rate should be set on an annual basis on 30 November, rather than ahead of each spending review period. There would have to be a validation at 31 March to ensure that there had not been a significant deviation between the 30 November rate and the rate that would apply if set at 31 March.

Comments should be sent to FReM.consultation@hmtreasury.gsi.gov.uk by 13 July 2011.

# Other developments

## Whole of government accounts

### 2010/11 guidance

Treasury has issued *Guidance to the whole of government accounts* which provides information on the 2010/11 WGA. It explains that Treasury is responsible for preparing WGA statements at a UK level. Treasury requires government departments to consolidate their agencies and non-departmental public bodies (NDPBs) with their own information and the elimination of intra-group data. WGA bodies submit their data to departments in an Excel spreadsheet called the C-Pack. The departments upload the C-Packs into Treasury’s Combined On line System (COINS), which is the consolidation software used to produce WGA. The Treasury then consolidates all the completed C-Packs, with information from the rest of the public sector, to prepare WGA for the UK. As Treasury is the primary consolidator, the departments are known as sub-consolidators. It should be noted that slightly different arrangements are in place for Scotland.

Each WGA body is issued by Treasury with a unique counter-party identification (CPID), which is used to identify other WGA bodies in the process for agreeing transaction streams and balances. A list of all bodies within the WGA boundary for 2010/11 is included in the C-Pack.

The deadline for the submission of C-Packs by central government bodies to auditors is 29 July 2011. The audit certification deadline is 26 August 2011.

The following paragraphs highlight the main revisions to the process, forms and C-Pack for 2010/11.

The process for agreeing transactions and balances between other WGA bodies requires more documentation. Where there are significant differences (i.e. greater than £200,000), the *CG-01 Agreement of balances form* should include details of the differences, including supporting papers. The supporting papers should include detailed explanations and further details that may be relevant, such as extracts from the accounts and nominal amounts of contracts.

The management review now requires to take place before creating the upload files from the C-Pack. The management of each body is required to review its WGA submission and complete the *CG-04 Management review checklist* which records the management processes of preparation, review and validation of WGA submissions. It also provides assurance that the information submitted by WGA bodies is in line with their accounts and that the quality of the data (particularly the counter-party data) is of the required standard. The C-Pack now allows a trial balance to be generated from the C-Pack, after validation of the data and before generation of the upload files.

Most opening balances are pre-populated in the C-Pack and cannot be overwritten. If adjustments are made as a prior period adjustment, an explanation requires to be given. Opening balances are not pre-populated for notes that were not included in last year's C-Pack, and the adjustment columns require to be used to provide prior year data.

Accounting tests have been revised and expanded to include, for example, a check that the cash flow statement balances. The C-Pack cannot be validated and uploaded if the cash flow statement does not balance.

An analytical review sheet has been added for comparing the current year with the prior year. Bodies are required to provide all required explanations and support them with evidence. This is important as Treasury relies on this when preparing the management commentary required in the WGA financial statements.

New audit 'gateway' tests have been introduced that require to be passed before auditors will accept the WGA submissions for audit. They are concerned with checking that the *Management review checklist* has been completed and that the C-Pack is consistent with COINS and the annul accounts.

Other changes include the following

- There is a requirement for bodies to complete a new *Trouble spot checklist*, which lists areas that many preparers have difficulty with and should double-check.
- The financial instruments disclosures have been revised to require basic information about balances from all bodies, and only require additional information about risk exposures for balances that are material to WGA.
- Information on non current assets held for sale is now captured in a new tab.

# Disclosure checklists

## 2010/11 checklist

The National Audit Office has issued a checklist that is designed to ensure that entities covered by the FReM have prepared their 2010/11 accounts in the appropriate form and have complied with all disclosure requirements.

The guide reflects the requirements of the 2010/11 version of the FReM as published as at 11 November 2010. It is cross-referenced to the FReM, and to individual international financial reporting standards, the *Companies Act 2006* and other relevant documents. In order to ensure that the guide is applied correctly, users may need to follow the cross-references to ascertain the full nature of the requirements and any exceptions.

While the guide is designed primarily for the NAO's internal use, it also applies to central government bodies in Scotland. It has been modified by the TSU to reflect the different guidance and legislative situation in Scotland to help auditors use it.

The modified checklist is available to inhouse auditors on the TSU intranet and has been emailed to the firms. Auditors may wish to use the checklist when auditing the 2010/11 accounts. The unmodified checklist is available from the NAO website.

# Grant and grant-in-aid

## Changes to SPFM

The *Grant and grant-in-aid* section of the *Scottish public finance manual* (SPFM) has been updated to provide clarification on the difference between the types of funding. The previous version differentiated between grant and grant-in-aid by stating that the former was appropriate when the Scottish Government wanted to maintain detailed control over the expenditure of the recipient body. This has been amended to state that grant-in-aid is pre-funding provided to sponsored bodies to finance their ongoing operating expenditure within broad parameters set by Scottish Ministers. Grant refers to funding provided to other organisations and individuals to finance expenditure on specific items or functions.

It has also been amended to clarify that the terms and conditions attached to grant-in-aid should take the form of a framework document consistent with the model management statement/financial memorandum in the SPFM section on *Accountability*.

# Key circulars

The following circulars can be obtained by using the hyperlinks, and are available to inhouse auditors from the TSU intranet.

## Finance guidance notes (FGN)

*FGN 2011/1 SPFM amendments* announced the following recent substantive amendments to the SPFM

- The sections providing guidance on activities undertaken by or on behalf of the *Auditor General for Scotland* have been updated and consolidated into a single section.
- The section on *Appraisal and evaluation* highlights the need, in undertaking relevant appraisals, to consider the scope for shared service arrangements with other public bodies.
- The section on *Grant and grant-in-aid* has been updated.  See Other developments – Grant and grant-in-aid – Changes to SPFM.
- The *Memoranda to accountable officers* published as annexes to the section on *Accountability* now include a specific responsibility to ensure that procurement activity is conducted in accordance with the *Procurement* section.

# Further education chapter

## Introduction

This chapter covers further education technical matters relevant to external auditors' responsibilities under their audit appointment to give an opinion on the financial statements. It should be read by external auditors with appointments in the further education sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance and urgent issue notes).

## Key circulars

The following circulars can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.

### SFC circulars

*SFC/09/2011 Main grants to colleges for academic year 2011/12* announced the allocation of main grants to colleges for 2011/12.

*SFC/11/2011 College sector bursary fund, discretionary fund and fee waiver grant policies 2011/12* advised of the publication of the 2011/12 national policies for college bursary fund, discretionary fund and fee waiver grant.

*SFC/12/2011 Allocation of additional English for speakers of other languages funding for colleges in academic year 2011/12* announced additional funding to increase the provision of the *English for speakers of other languages* programme in 2011/12.

*SFC/13/2011 Education maintenance allowance 2011/12* describes the education maintenance allowance programme for 2011/12.

# Contact points

Specific enquiries or requests for further information relating to articles contained in each chapter of this TB should be made to

| Cross-sectoral chapter | Health chapter |
|---|---|
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| **Local authority chapter**<br>Paul O'Brien<br><br>Tim Bridle, Technical Adviser (Local Government)<br>Tel: 0131 625 1793<br>E-mail: tbridle@audit-scotland.gov.uk<br><br>Owen Smith, Manager – Benefits (Technical)<br>Tel: 0131 625 1914<br>E-mail: osmith@audit-scotland.gov.uk | **Central government chapter**<br>Ann-Marie Mclaughlin, Technical Adviser (Central Government & Further Education)<br>Tel: 0131 625 1969<br>E-mail: ammclaughlin@audit-scotland.gov.uk<br><br>**Further education chapter**<br>Ann-Marie Mclaughlin |

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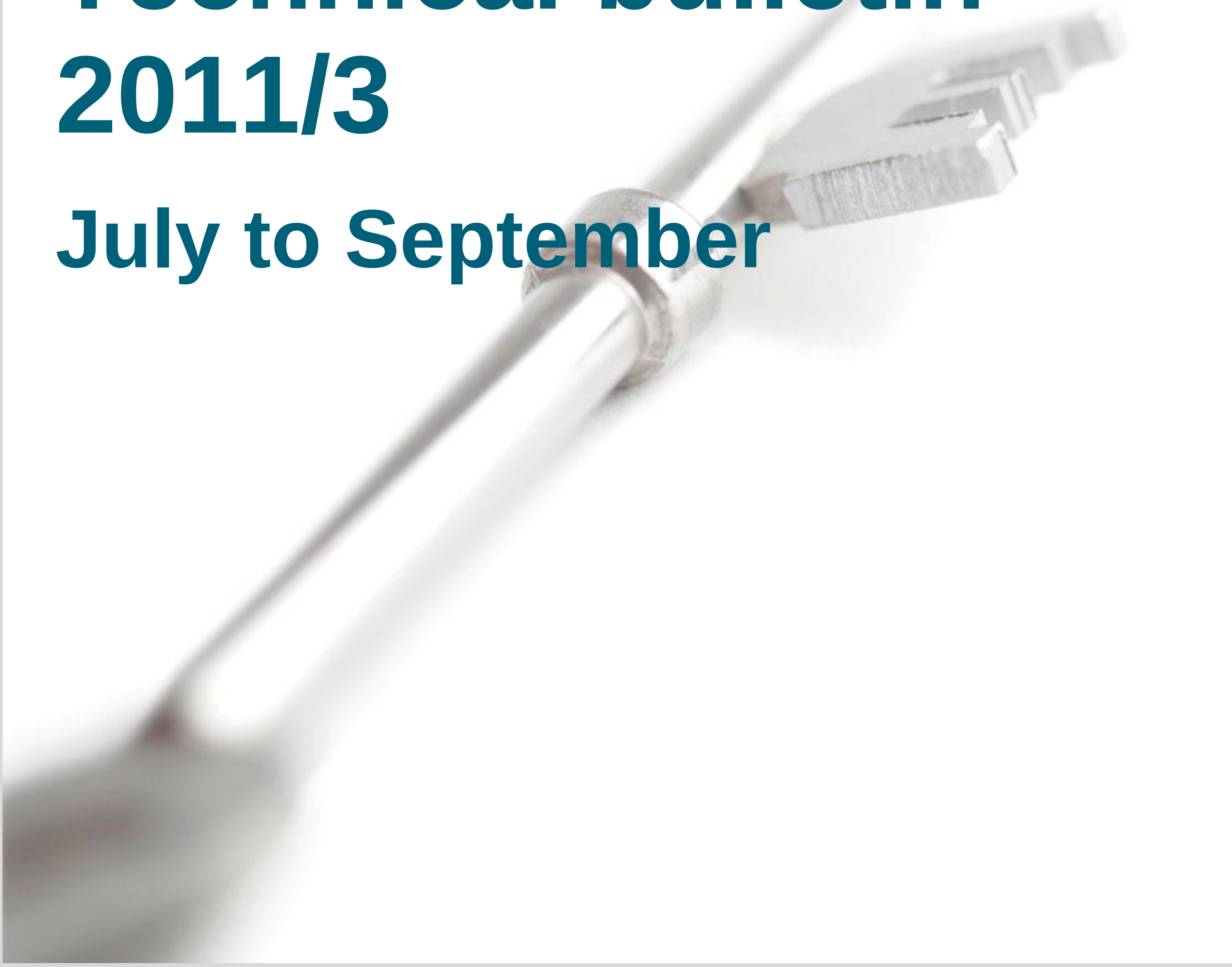
**22 June 2011**

# Technical bulletin 2011/3

## July to September



AUDIT SCOTLAND

Prepared by the Technical Services Unit
23 September 2011

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

# Contents

# Foreword

Audit Scotland's Technical Services Unit (TSU) provides guidance to external auditors appointed by the Accounts Commission and Auditor General to support them in carrying out their responsibilities under the *Code of audit practice* to

- provide an opinion on audited bodies' financial statements and, where required, the regularity of transactions
- review and report on other information published with the financial statements, including statements on internal control (and equivalent governance statements) and remuneration reports
- examine and report on approved grant claims and other returns submitted by local authorities
- review and report on whole of government accounts returns.

This includes the publication of technical bulletins (TBs) at quarterly intervals onto the TSU intranet and Audit Scotland website. The purpose of TBs is to summarise technical developments in the quarter for external auditors, and to provide auditors with guidance where required.

TBs frequently recommend that auditors take certain actions, and a summary of these actions is provided at the end of each chapter. It is important that a mechanism is in place for senior audit staff to review the TB promptly and to ensure that steps are taken to consider such recommendations.

While auditors act independently of Audit Scotland, and are responsible for their own conclusions and opinions, consistency of opinions in similar circumstances is important and it is expected therefore that auditors will normally follow all TSU guidance. Auditors should advise the TSU promptly if they disagree with, and may intend not to follow, any guidance provided on an important issue (e.g. a matter that required consideration to be given to the qualification of the accounts of a number of audited bodies).

TBs are also published on the Audit Scotland website so that audited bodies and other stakeholders can be aware of the guidance that has been issued to auditors. In selecting items for inclusion in TBs the bias is towards those which are of particular interest to external auditors. TBs should not therefore be regarded as providing an exhaustive review of all matters relevant to audited bodies.

Audit Scotland makes no representation as to the completeness or accuracy of the contents of TBs or that legal or technical guidance is correct. Points of law, in particular, can ultimately be decided only by the Courts. Audit Scotland accepts no responsibility for any loss or damage caused as a result of any person relying upon anything contained in a TB.

# Headlines

**The table in this chapter provides brief headlines for the content of this TB, referenced to the paragraphs containing the main article.**

| Cross-sectoral chapter | Reference |
|---|---|
| The International Auditing and Assurance Standards Board has issued<br>• proposed amendments to IFRS 1, IAS 1 and IAS 16<br>• a proposed change to the effective date of IFRS 9. | Paragraph 1<br>Paragraph 6 |
| The Financial Reporting Council has issued<br>• a paper on the continuing relevance of the true and fair requirement<br>• a report which sets out the main findings from discussions with organisations on approaches to risk management. | Paragraph 10<br>Paragraph 14 |
| Audit Scotland has issued reports on<br>• on how public bodies are beginning to respond to the challenge of reducing public expenditure<br>• transport for health and social care<br>• an overview of the criminal justice system<br>• modernising the planning system. | Paragraph 16<br>Paragraph 17<br>Paragraph 18<br>Paragraph 19 |

| Local authority chapter | Reference |
|---|---|
| The TSU has<br>• published a note for guidance on auditing the 2010/11 whole of government accounts | Paragraph 20 |

| Local authority chapter | Reference |
|---|---|
| • published a grant note on auditing the 2010/11 non domestic rate income returns<br>• provided guidance on accounting changes in respect of injury benefits in 2010/11<br>• requested auditors to send to the TSU their ISA 260 written communications in respect of local government bodies for 2010/11<br>• provided guidance in respect of the audit of local authority charities in 2010/11. | Paragraph 22<br>Paragraph 24<br>Paragraph 27<br>Paragraph 29 |
| The CIPFA/LASAAC Local Authority Code Board has issued<br>• an invitation to comment on the draft *Code of practice on local authority accounting in the UK 2012/13*<br>• an invitation to comment on the draft *Code of practice on local authority accounting in the UK 2011/12 update.* | Paragraph 36<br>Paragraph 49 |
| The Chartered Institute of Public Finance and Accountancy has issued<br>• an exposure draft of proposed changes to the *Service reporting code of practice* for 2012/13.<br>• a briefing on improving the use of cost information in councils | Paragraph 52<br>Paragraph 105 |
| The Local Authority (Scotland) Accounts Advisory Committee has issued a guide intended to help elected members scrutinise their local authority's financial statements from 2010/11. | Paragraph 108 |

| Local authority chapter | Reference |
|---|---|
| The Scottish Government has issued<br>• a consultation paper that sets out proposed changes to fixed repayment periods for loans fund advances from 2012/13<br>• 2010/11 whole of government accounts consolidation packs and guidance<br>• guidance on a scheme to allow local authorities to borrow to meet equal pay costs in 2011/12<br>• guidance on a scheme to allow local authorities to borrow to meet severance costs in 2011/12<br>• a consultation paper on a single police authority and single fire board<br>• an email that clarifies the approach to remuneration reports in community justice authorities. | Paragraph 56<br>Paragraph 64<br>Paragraph 80<br>Paragraph 85<br>Paragraph 98<br>Paragraph 103 |
| The Audit Commission has issued<br>• module 4 of the 2010/11 HB COUNT which provides the analytical review tool component of the approach to the audit of benefit subsidy claims<br>• an e-learning package on the 2010/11 HB COUNT approach to the audit of benefits subsidy claims. | Paragraph 73<br>Paragraph 76 |
| The Office of the Scottish Charity Regulator has sent a letter to local authorities setting out their reporting requirements from 2010/11 in respect of local authority charities. | Paragraph 94 |

| Health chapter | Reference |
|---|---|
| The TSU has provided an update on the consolidation of NHS charitable funds. | Paragraph 111 |

| Health chapter | Reference |
|---|---|
| The Scottish Government Health Directorate has issued letters/reports on<br>• eyecare integration project<br>• the 2011/17 eHealth strategy<br>• changes in the NHS workforce<br>• the withdrawal of the national recruitment and retention premia<br>• 2011/12 ophthalmic allowances and voucher values<br>• 2011/12 general medical services contract. | <br>Paragraph 121<br>Paragraph 123<br>Paragraph 129<br>Paragraph 133<br>Paragraph 136<br>Paragraph 138 |
| The Scottish Parliament Information Centre has issued briefings which provide<br>• an introduction to the NHS in Scotland<br>• an overview of the NHS in Scotland funding. | <br>Paragraph 114<br>Paragraph 115 |
| The Audit Commission has issued a report on the audit of 2010/11 accounts for NHS bodies in England. | Paragraph 142 |
| The National Audit Office has issued a briefing on the 2010/11 audit of the Department of Health. | Paragraph 143 |

| Central government chapter | Reference |
|---|---|
| The TSU has published a note for guidance on auditing the 2010/11 whole of government accounts. | Paragraph 144 |
| Treasury has issued exposure drafts of proposed amendments to the 2011/12 *Government financial reporting manual* in respect of | |

| Central government chapter | Reference |
|---|---|
| • the application *IFRIC 19 Extinguishing financial liabilities with equity instruments*<br>• the application of *IFRS 8 Operating segments*<br>• replacing the statement on internal control with a governance statement. | Paragraph 147<br>Paragraph 151<br>Paragraph 155 |
| Treasury has also issued an updated edition of the *Green book*. | Paragraph 157 |
| The Scottish Government has announced recent amendments to the *Scottish public finance manual* in respect of<br>• severance schemes<br>• delegated authority<br>• borrowing, lending and investment | Paragraph 160<br>Paragraph 167<br>Paragraph 168 |

| Further education chapter | Reference |
|---|---|
| The TSU has published a note for guidance on auditing the 2010/11 further education financial statements. | Paragraph 170 |
| The Scottish Funding Council has issued<br>• the accounts direction from 2010/11<br>• guidance notes to support the accounts direction<br>• a suggested discount factor for early retirement provision<br>• model financial statements for 2010/11<br>• a circular on 2011/12 childcare funds. | Paragraph 172<br>Paragraph 176<br>Paragraph 180<br>Paragraph 182<br>Paragraph 183 |

| Further education chapter | Reference |
| --- | --- |
| The Scottish Parliament Information Centre has issued a briefing which provides an overview of Scotland's college sector. | Paragraph 184 |

# Cross-sectoral chapter

## Introduction

**This chapter contains articles on cross-sectoral technical developments and guidance relevant to external auditors' responsibilities under their audit appointment. It should be read by all external auditors. Developments and guidance that are relevant to only one sector are covered in the relevant sector-specific chapter. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance, urgent issue notes and, for local authorities, grant notes).**

**The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to inhouse auditors on the TSU intranet.**

**In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that there are no articles in this chapter that relate to 2010/11 audits.**

**The TSU encourages feedback on this TB. Comments should be sent to alewis@audit-scotland.gov.uk.**

## Accounting developments

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

### Proposed amendments to IFRS 1, IAS 1 and IAS 16

1. The International Accounting Standards Board (IASB) has issued ED/2011/2 Improvements to IFRSs which contains proposed changes to the following international financial reporting standards (IFRS)
   - *IFRS 1 First-time adoption of international financial reporting standards*
   - *IAS 1 Presentation of financial statements*
   - *IAS 16 Property, plant and equipment*
2. The exposure draft proposes to amend IFRS 1 in respect of borrowing costs to clarify that
   - an entity that capitalised borrowing costs in accordance with its previous GAAP before the date of transition to IFRS may carry forward, without adjustment, the amount previously capitalised in the opening statement of financial position at the date of transition

- borrowing costs incurred after the date of transition that relate to qualifying assets under construction at the date of transition should be accounted for in accordance with *IAS 23 Borrowing costs*.

3. It proposes to amend IAS 1 to
   - clarify that additional financial statement information need not be presented in the form of a complete set of financial statements for periods beyond the minimum comparative information requirements
   - clarify that the appropriate date for the opening statement of financial position is the beginning of the required comparative period (rather than an earlier period where additional comparative information is provided voluntarily)
   - change the current requirements to no longer require notes to the opening statement of financial position.

4. There is also a proposal to clarify in IAS 16 that servicing equipment should be classified as property, plant and equipment when it is used during more than one period; and as inventory if it is not.

5. Comments should be made via www.ifrs.org by 21 October 2011. It is proposed that the amendments will apply from 1 January 2013.

## Proposed change to effective date of IFRS 9

6. The IASB has issued ED/2011/3 Mandatory effective date of IFRS 9 which contains a proposed change to the effective date of *IFRS 9 Financial instruments*.

7. The project to replace *IAS 39 Financial instruments: Recognition and measurement* has been undertaken in several phases. The first phase addressed the classification and measurement of financial instruments and resulted in the issue of IFRS 9 for application to annual periods beginning on or after 1 January 2013.

8. Owing to the extension of the time line for completion of the remaining phases, it is proposed to change the mandatory effective date to 1 January 2015. Early application would continue to be permitted.

9. Comments should be made via www.ifrs.org by 21 October 2011.

## Paper on true and fair

10. The Financial Reporting Council (FRC) has issued a paper called True and fair which discusses the continuing relevance of the true and fair requirement, and confirms that it remains of fundamental importance.

11. It emphasises that the preparation of financial statements cannot be reduced to a mechanistic process of following the relevant accounting standards without the application of objective professional judgement to ensure that those statements give a true and fair view.

Professional judgement is essential and applies at all stages of preparation of the accounts, for example

- ensuring that appropriate accounting policies are selected
- not using detailed accounting rules as an excuse for poor accounting
- giving appropriate disclosures even where not specifically required
- ensuring that significant information is not obscured by immaterial or irrelevant disclosures.

12. In the vast majority of cases, compliance with accounting standards will result in a true and fair view, and disagreement with a particular standard does not provide grounds for departing from it. However, in extremely rare circumstances, where directors and auditors do not believe that following a particular accounting policy will give a true and fair view, they are required to adopt a more appropriate policy, even if this requires a departure from the standard. In addition, IAS 1 requires an item to depart from a standard if it does not represent faithfully the transactions it purports to represent.

13. In summary, the paper expects preparers, those charged with governance and auditors to

- always stand back and ensure that the accounts as a whole give a true and fair view
- be prepared, in extremely rare circumstances, to consider using the true and fair override
- ensure that the consideration they give to these matters is evident in their deliberations and documentation.

## Corporate governance developments

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

### Risk management

14. The FRC has issued a report called Boards and risk: A summary of discussions with companies, investors and advisors which sets out the main findings from discussions with organisations on approaches to risk management.

15. The *UK Corporate governance code* states that boards are responsible for determining the nature and extent of the significant risks they are willing to take in achieving their strategic objectives, and requires them to maintain sound risk management and internal control systems. The FRC held a series of meetings to learn more about how boards were approaching these responsibilities. The purpose of this report is to share the insights gained about the issues boards were facing, and the ways they were addressing them, to reflect and contribute to best practice. Main findings include the following

- Boards should agree their appetite or tolerance for key individual risks. They should understand the exposure to risk, and how this might change as a result of changes to strategy and the operating environment, and take a view on these changes.

- Boards should focus on those risks capable of undermining the strategy or long-term viability of the organisation or damaging its reputation.  Reputational risk has grown in importance and requires greater attention.
- A focus only on ‘net risk‘ could be dangerous, and it is essential that boards have a view on the organisation’s potential exposure to risk.  Boards need a view of the combination of risks before the application of mitigation policies (‘gross risk‘), in order to consider their effectiveness.
- One of the greatest challenges is judging how much information is required by the board to perform its role, including determining when a particular risk should be brought to the board’s attention.

# Publications

**The following publications can be obtained by using the hyperlinks.**

## Audit Scotland

**Scotland's public finances: Addressing the challenges**

16. This report Scotland's public finances: Addressing the challenges provides an overview of how public bodies are beginning to respond to the challenge of reducing public expenditure in line with budget cuts.  It provides a snapshot of progress as at January to April 2011.  Key messages include
    - Most bodies surveyed have been able to agree a balanced budget for 2011/12. However, there are risks that savings may not be realised or that unforeseen pressures will emerge. Public bodies are finding it difficult to plan beyond 2011/12, as they do not have a clear view of their budgets beyond that year.
    - The need to reduce costs provides public bodies with an opportunity to reform and streamline public service delivery. This requires a clear understanding of the organisation’s costs, including how different activity levels affect costs, and a clear methodology for setting budgets based on priorities and the outcomes to be achieved.
    - Pay restraint and reducing workforce levels are the most common approaches being taken by public bodies to reduce costs over the next few years.
    - While a number of initiatives are being planned to increase working together, sharing resources and involving voluntary and private organisations, progress to date has been limited. It is likely to be a number of years before cost savings are realised.

**Transport for health and social care**

17. This report Transport for health and social care assesses the efficiency and effectiveness of transport for health and social care in Scotland.  Key messages include the following
    - Transport services for health and social care are fragmented and there is a lack of leadership, ownership and monitoring of the services provided.

- The Scottish Government, regional transport partnerships, councils, NHS boards and the ambulance service are not working together effectively or making best use of available resources.
- Data on costs, activity and quality is poor, but from the limited information available the report identifies that over £93 million was spent in 2009/10.
- Improved joint planning could lead to more efficient services. Pilot projects show there is scope for efficiencies, but these lessons have not been applied across Scotland.
- The potential effect of changes to services is not often assessed or monitored and alternative provision is not always put in place.

### An overview of Scotland's criminal justice system

18. This report An overview of Scotland's criminal justice system focuses on aspects of the adult criminal justice system to identify where there is potential to improve efficiency and effectiveness. Key messages include the following
    - There have been significant changes to the criminal justice system since devolution, which have delivered major reform but have also contributed to its complexity.
    - It is difficult to manage criminal justice processes as a whole system, although joint working has improved in recent years.
    - The reduction in the revenue budget for the six main criminal justice bodies (excluding police) of 7% in real terms in 2011/12; and 64% for the capital budget, represent risks to the long-term sustainability of services.
    - There are significant inefficiencies in the criminal justice system, e.g. inefficiencies in processing cases cost at least £10 million in 2009/10.

### Modernising the planning system

19. This report Modernising the planning system assesses whether recent reform and modernisation of the planning system is making it more economic, efficient and effective. Key messages include the following
    - The Scottish Government, key agencies and planning authorities have made progress in modernising the planning system and are working better together. However, more progress is needed to realise the full potential of modernisation.
    - Few councils are performing well against timescales for processing planning applications, and a more comprehensive performance measurement framework is needed.
    - The funding model for processing planning applications is becoming unsustainable as the gap between income and expenditure is widening.

# Local authority chapter

## Introduction

**This chapter contains articles on local authority technical developments and guidance relevant to external auditors' responsibilities under their audit appointment. It should be read by external auditors with appointments in the local authority sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance, urgent issue notes and grant notes).**

**The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to inhouse auditors on the TSU intranet.**

**In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that the following articles in this chapter relate to 2010/11 audits**

- Note for guidance on whole of government accounts,
- Grant note on non-domestic rate income returns
- TSU guidance on injury benefits, and the audit of charities
- TSU request for ISA 260 written communications
- Whole of government accounts consolidation pack and guidance notes
- HB COUNT module 4 and e-learning package
- Charities reporting requirements.

## TSU developments

### Publications

**The following note has been published by the TSU since TB 2011/2. It can be obtained by using the hyperlink and is available to inhouse auditors from the TSU intranet.**

**Note for guidance on 2010/11 whole of government accounts**

20. The TSU has published Note for guidance 2011/8(LA) 2010/11 whole of government accounts (local government) to provide auditors with guidance on auditing the 2010/11 whole of government accounts (WGA) consolidation packs (L-Packs) of local authorities.

21. Auditors should have used this guidance when reviewing and reporting on local authorities' 2010/11 WGA returns.

**Grant note GN/NDR/11**

22. The TSU has published Grant note GN/NDR/11 2010/11 non domestic rates income returns to provide auditors with guidance on auditing the 2010/11 non domestic rate (NDR) income returns.

23. Auditors should use this guidance when auditing local authorities' 2010/11 NDR returns.

## Other guidance

**The following articles provide other guidance, updates or requests from the TSU.**

**2010/11 injury benefits**

24. The *Code of practice on local authority accounting in the UK* (the Code) for 2010/11 requires (at paragraph 6.2.3.6) that, where some or all of an injury benefit depends on length of service, the benefit should be accrued as that service is rendered. This requires projections by the actuary as to how many employees might have to retire through injury and the years of service they might have accrued at that time.

25. In previous years, most actuaries calculated the liability associated with injury benefits on the basis of benefits currently in payment. For those actuaries, the Code requirement represents a change in the basis of calculating the liability at 31 March 2011.

26. The TSU discovered towards the end of August that there was some doubt as to how this change should be accounted for, and therefore sent an email to auditors of police and fire authorities to clarify that it represents a change in accounting policy. Where material, prior period adjustments are necessary to make sure that, in the 2010/11 accounts, the 2009/10 comparatives are consistent with the 2010/11 figures and the 1 April 2009, 31 March 2010 and 31 March 2011 balance sheets are all prepared on the same basis.

**ISA 260 communications**

27. *ISA 260 Communication with those charged with governance* requires auditors to communicate in writing with those charged with governance regarding significant findings from the audit.

28. In order to enhance the TSU's understanding of the type of technical matters being reported, with a view to informing future notes for guidance, auditors are requested to send a copy of their ISA 260 written communications in respect of local government bodies for 2010/11 to alewis@audit-scotland.gov.uk.

**Audit of charities in 2010/11**

29. There has been a change in the audit requirements for 2010/11 in respect of registered charities administered by local authorities.

30. The Office of the Scottish Charity Regulator (OSCR) has sent a letter to councils regarding their reporting requirements for local authority charities from 2010/11 (see paragraph 94). The letter stated that an independent examination report would continue to be accepted until 2012/13, and that an audit report would not be required until 2013/14.

31. However, the TSU has subsequently been advised by an auditor that OSCR has emailed a council to say that an audit report is required in 2010/11 where a charity's gross income exceeds £500,000 or gross assets exceeds £2.8 million.

32. Regulation 10(2) (as amended) of *The Charities Accounts (Scotland) Regulations 2006* (the charities regulations) states that the accounts must be audited by (i) an auditor eligible to act as an auditor under the Companies Act (ii) the Auditor General or (iii) an auditor appointed by the Accounts Commission. It is therefore likely that auditors will be approached by councils with a request to audit their set of charities accounts where they contain a charity which breaches this threshold.

33. Given the late stage at which OSCR has made this requirement explicit, and mindful that this is the last year of the current audit appointments, Audit Scotland does not require council auditors to undertake the charities audit in 2010/11. However, if approached with a request, auditors may choose to do so as a separate engagement. Auditors should note that

- Accounts for relevant charities consists of
  - a statement of financial activities which shows the total incoming resources and application of the resources, together with any movements in the total resources, of the charity during the financial year
  - a balance sheet
  - a cash flow statement, if appropriate
  - notes to the accounts
  - a trustees annual report.
- The accounts require to be prepared in accordance with the methods and principles set out in the *Statement of recommended practice for accounting and reporting by charities* (the charities SORP).
- The duties of an auditor are set out in Regulation 10 of the charities regulations. They include a requirement to make a report on the accounts to the charity trustees that states whether the accounts comply with the requirements of Regulation 8, give a true and fair view of the state of affairs of the charity at the end of the financial year and of the incoming resources and application of the resources of the charity in that financial year
- The submission deadline is the 31 December.

34. Firms are eligible to undertake the charities audit by virtue of the Companies Act eligibility and may do so, if they choose, without contacting Audit Strategy. However, inhouse auditors are only eligible to undertake the charities audit if they are appointed by the Accounts Commission to do so. If inhouse auditors wish to undertake the charities audit in 2010/11, they should

contact jgilchrist@audit-scotland.gov.uk as soon as possible who will arrange for a letter of appointment.

35. Audit Scotland is considering the approach to the audit requirements from 2011/12 and will advise auditors of the outcome in due course.

# Accounting developments

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

## Draft 2012/13 Code

36. The CIPFA/LASAAC Local Authority Code Board has issued an invitation to comment on the draft Code for 2012/13. Auditors' attention is drawn to proposed changes in respect of

- the explanatory foreword
- financial instrument disclosure
- amendments arising from the new conceptual framework from the IASB
- transport infrastructure assets.

37. Responses should be sent to Code.responses@cipfa.org by 30 September 2011.

### Explanatory foreword

38. CIPFA/LASAAC has reviewed the Code's provisions on the publication of an explanatory foreword and the proposal for 2012/13 is that authorities should be encouraged to base the explanatory foreword on either

- the IASB's practice statement *Management commentary – A framework for presentation*; or
- the requirements of the *Government financial reporting manual* (the FReM).

39. For the longer term, the proposed future approach is to require the production of a management commentary in accordance with the reporting requirements of the FReM, taking into consideration the practice statement. A management commentary is a narrative report that provides an explanation of the authority's financial position, financial performance and cash flows. It also provides commentary on an authority's prospects and other information not presented in the financial statements, as well as management's objectives and strategies.

40. The FReM's requirements are based on the business review required by section 417 of the *Companies Act 2006*, including the requirement to disclose key performance indicators, and authorities would be required to

- meet the requirements of section 417 subject to certain interpretations
- make additional specific disclosures based on relevant requirements of the FReM

- reflect the recommended list of topics for an explanatory foreword included in the 2011/12 Code.

41. It is proposed that the management commentary would be authorised by the Leader of the Council, the Chief Executive and the Chief Financial Officer.

**Financial instrument disclosure**

42. It is proposed that the Code should incorporate the amendments to *IFRS 7 Financial instruments: Disclosures* in respect of the transfers of financial assets. Authorities would be required to provide specified disclosures for all transferred financial assets that are not derecognised and for any continuing involvement in a transferred asset, existing at the reporting date. Authorities would be required to present the required disclosures in a single note.

43. For the purposes of applying the disclosure requirements, an authority transfers a financial asset only if it either

    - transfers the contractual rights to receive the cash flows of that financial asset; or
    - assumes a contractual obligation to pay the cash flows.

44. CIPFA/LASAAC is of the view that the transfers described by the standard do not occur frequently in local authorities and therefore it is proposed that the Code should refer authorities to the standard for the required disclosures rather than set them out in the Code itself.

45. It should be noted, however, that the amendments to IFRS 7 have yet to be adopted by the EU and the proposals may need to be revised if they are not adopted in time for inclusion in the 2012/13 Code.

**Conceptual framework**

46. There is a proposal to reflect the development of the IASB's new conceptual framework (see TB 2010/4 - page 5). Although the IASB has finalised the first phase of the project, CIPFA/LASAAC is of the view that it should not update the Code until the framework is completed.

47. The proposed amendments to the 2012/13 Code therefore only inform authorities of the new provisions of the framework and require that these provisions should be taken into account if the treatment of a transaction is not covered by a specific Code requirement.

**Transport infrastructure assets**

48. CIPFA/LASAAC is considering a move in the Code at some point in the future for measuring transport infrastructure assets from a depreciated historical cost basis to a depreciated replacement cost (DRC) basis as set out in the *Code of practice on transport infrastructure assets*. However, it is proposed to permit authorities to voluntarily adopt a DRC basis in 2012/13, and the exposure draft offers the following two options for early adoption

- Model 1 involves amending the measurement provisions in the Code to permit authorities to measure their transport infrastructure assets on a DRC basis. This would require DRC comparative information for 2011/12, and a note disclosing the equivalent depreciated historical cost information.
- Model 2 permits early adoption by means of an additional disclosure note presenting transport infrastructure assets on a DRC basis, as opposed to full recognition in the financial statements.

## Draft 2011/12 Code update

49. The CIPFA/LASAAC Local Authority Code Board has also issued an invitation to comment on the draft invitation to comment on a draft update to the 2011/12 Code. The update is required as there have been a number of developments to statutory accounting or disclosure requirements which have taken place since the publication of the 2011/12 Code.

50. The items that apply to Scottish authorities relate to the incorporation of the new requirements for the production of a remuneration report and for reporting local authority pension funds, as well as statutory guidance on accounting for investments, capital grants, and investment properties. The proposed items are intended to reflect the requirements of the regulations and statutory guidance, and do not introduce new requirements.

51. Responses should be sent to Code.responses@cipfa.org by 30 September 2011.

## Draft 2012/13 service reporting code of practice

52. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued an exposure draft of proposed changes to the *Service reporting code of practice* for 2012/13.

53. The only proposed change that affects Scottish authorities is in respect of the recommended standard subjective analysis in relation to the carbon reduction commitment (CRC) scheme. It is proposed that CRC allowances should be charged to services on a reasonable basis that fairly reflects the production of CRC carbon emissions.

54. It is recommended that the cost of CRC allowances is apportioned in accordance with the method used to apportion other energy cost charges, as part of premises costs (group 2).

55. Responses were required by 16 September 2011.

# Other developments

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

## Treasury management

### Proposed changes to loans fund repayment periods

56. The Scottish Government has issued a consultation paper that sets out proposed changes to fixed repayment periods for loans fund advances from 2012/13. Local authorities are required by Schedule 3 of *the Local Government (Scotland) Act 1975* (the 1975 Act) to establish and maintain a loans fund, and to advance from the loans fund sums required to fund capital expenditure. All such sums advanced require to be repaid within a fixed period.

57. Fixed periods are currently set out in finance circular 29/1975. However, the consultation paper proposes that, rather than prescribing fixed periods, the fixed period should reflect the useful life of the asset or component in line with accounting principles. It is therefore proposed that the fixed period for any advance should be the same period as the useful life identified when the asset is first acquired, subject to specified maximum periods. Where the useful life of an asset is revised after initial recognition, or the asset becomes surplus, the fixed period should not be changed. Where the asset has an unlimited or indefinite useful life (e.g. land, heritage assets) the fixed period should be determined by the local authority subject to the relevant maximum period.

58. The proposed maximum periods for each type of asset are

- 100 years for council dwellings, other land and buildings, community assets and heritage assets
- 60 years for infrastructure
- 50 years for vehicle and plant
- 20 years for furniture and equipment and intangible assets.

59. Scottish Ministers may approve longer periods in exceptional circumstances. As investment property is used for investment rather than for operational purposes, the proposed maximum period for investment properties is 1 year.

60. Where an asset which is the subject of a loan fund advance is sold, the fixed period is equal to the actual life of the asset. Any outstanding loan fund advance should be written down when an asset is sold, and the capital receipt should be used to finance the write off of the advance. Where the capital receipt is insufficient, the balance should be repaid over the remaining fixed period. Local authorities may choose to use a shorter period.

61. The 1975 Act requires the first repayment of any loans fund advance to be made within twelve months, including advances in respect of assets under construction. The consultation paper proposes that the legislation should be amended so that the fixed period would commence

from the year that the asset is available for use to bring it into line with the requirements for depreciation.

62. It is proposed that these changes will apply from 1 April 2012. The fixed period for any advances made prior to that date will not be changed. However, the revised proposals will apply to all assets sold from that date.

63. Responses should be sent to hazel.black@scotland.gsi.gov.uk by 30 September 2011.

## Whole of government accounts

### 2010/11 pack and guidance notes

64. The Scottish Government has issued 2010/11 WGA consolidation L-Pack for use by local authorities which requires to be completed by local authorities in accordance with accompanying guidance notes to give information for inclusion in 2010/11 WGA.

65. The 2010/11 L-Pack is designed to follow the Code and the supporting practitioners' guidance notes. Most of the data required continues to be obtained for authorities' published accounts, with the additional requirement to collect information on major transaction streams and balances within the public sector to allow these to be eliminated on consolidation.

66. A key change from 2009/10 was the process for submitting the L-Packs for audit. After the unaudited L-Packs had been uploaded by the Scottish Government, they were sent back to auditors, and copied to authorities, with a navy banner in row 3 of the overview sheet, indicating that this was the pack used for the upload. It is important that this was the version audited to prevent any version control issues in the generation of the automated audit adjustment journal.

67. The stages of the completion, submission and validation of the L-Packs were therefore as follows

- Authorities checked that all the primary validations were passed, locked the draft pack, and submitted it to the Scottish Government.
- The Scottish Government uploaded the draft data and sent the pack (with the navy banner) to auditors to carry out the audit of the pack
- Agreed adjustments are made to the pack, and authorities lock the final pack
- Auditors press the (password protected) audit completion button
- The locked L-Pack is submitted to the Scottish Government.

68. As the 2010/11 WGA is the second to be published, comparatives require to be included. Information is therefore required on the movement from closing balances based on UK GAAP to the restated IFRS opening balances. Also, the move to IFRS means that WGA must meet the disclosure requirements of IFRS 1. New sections have been added to the prior year restatement sheet to help meet these requirements. In addition, a second restatement sheet has been added to collect the details necessary for the notes.

69. Other changes to the L-Packs as a result of the move to IFRS include the investment properties disclosure format, assets held for sale, and capital grants. In addition, the financial instrument requirements have significantly reduced as financial guarantees, derivatives and hedges have been removed, and there is now only one sheet. However, investments require to be split between bodies inside and those outside the WGA boundary, with greater analysis required for those that are outside

70. The number of primary validations has increased and they must be passed before the L-Pack can be submitted. The number of data integrity checks has increased significantly and explanations require to be provided where these secondary tests fail.

71. The deadline for unaudited WGA L-Pack being submitted to the Scottish Government was 29 July 2011. The audited return must be with the Scottish Government no later than 30 September 2011.

72. Auditors should refer to this guidance when auditing the 2010/11 WGA L-Packs. Guidance for auditors is provided in note for guidance 2011/8(LA).

## Benefits

### 2010/11 HB COUNT module 4

73. The Audit Commission has issued module 4 of the 2010/11 HB COUNT which provides the analytical review tool component of the approach to the audit of benefit subsidy claims. This tool enables auditors to review subsidy claim forms by comparing 2010/11 information with 2009/10 and with other authorities. It provides a number of useful worksheets including the following two which require to be completed

- The year-to-year worksheet where 2009/10 claim data is entered manually for comparison against 2010/11 data. Any significant variances identified should be explained.
- The key ratios worksheet that allows comparison with other authorities. Any ratios highlighted in red should be reviewed to establish the reason.

74. The information is for auditor use only. If auditors wish to provide authorities with outputs, they should ensure that the data for other authorities is anonymised.

75. Auditors should have completed module 4 as part of the audit of the 2010/11 benefit subsidy claims.

### HB COUNT 2010/11 e-learning package

76. The Audit Commission has issued an e-learning package on the 2010/11 HB COUNT approach to the audit of benefits subsidy claims.

77. The e-learning package provides an introduction to benefits and subsidy, and covers the audit role in subsidy audit and the audit approach using HB COUNT. It has been designed for auditors new to benefits work or to HB COUNT, and also for those who wish to refresh their understanding of elements of the approach.

78. This package is being provided instead of the training workshops that have been delivered in previous years.  Although the package is written from an English perspective, and uses Audit Commission terminology (e.g. qualification letters), the principles also apply to Scotland. Auditors should refer to GN/HBS/11 for how the approach applies to the audit of Scottish subsidy claims.

79. Auditors should have completed this e-learning training package before undertaking the 2010/11 HBCOUNT subsidy audit.

## Equal pay

**2011/12 borrowing consent**

80. The Scottish Government has issued Finance circular 9/2011 Consent to borrow under para 1(2) of Schedule 3 of the Local Government (Scotland) Act 1975 – Equal pay which attaches guidance on a scheme to allow local authorities to borrow to meet equal pay costs.  The 1975 Act provides Scottish Ministers with the power to consent to a local authority borrowing to meet costs that it would not otherwise be able to meet from borrowing.  A consent scheme has been in existence since 2009/10 that allows authorities to borrow for lump sum equal pay costs.  This scheme has been extended to apply to 2011/12.

81. Applications under a previous scheme do not bar a local authority from applying under the 2011/12 scheme.  However, applications are only likely to be successful where the total equal pay costs have increased, or other external factors have had a significant effect on the authority's finances.

82. As with previous schemes, the Scottish Government requires applications in the form of a business case which provides information set out in a checklist at Annex A to the circular. Applications will be assessed to determine that the costs in the application are eligible for consent to borrow.  Decisions as to whether to provide consent to individual councils will be primarily based on financial need.

83. Details of the scheme are largely unchanged from previous years, and therefore key features continue to be as follows

- The Scottish Government will consider the level of funds, provisions and reserves, available to the local authority to meet equal pay costs.  Local authorities will need to make a very strong case for any earmarked reserves to be disregarded.
- The only expenditure for which consent is likely to be given is the one-off lump sum back-pay payments to present or former employees in respect of equal pay.  The local authority may not use a borrowing consent in the same year that there is a revenue contributions to the capital programme.
- The consent to borrow is valid for the financial year in which it is issued, plus one further financial year.  If the consent to borrow is still needed but the expenditure is unlikely to be incurred by the expiry date, the local authority may apply to the Scottish Government to extend the period of the consent.

- Where borrowing is undertaken using the consent to borrow, a separately identifiable advance from the loans fund should be made. The period for the repayment of the advance may not exceed 20 years. Capital receipts may be used to meet the cost of the principal element of the loans fund advance.

84. Local authorities are required to apply for consent by 23 September 2011, and the Scottish Government intends to issue any consents by 16 December 2011.

## Severance schemes

**2011/12 borrowing consent**

85. The Scottish Government has issued Finance circular 10/2011 Consent to borrow under para 1(2) of Schedule 3 of the Local Government (Scotland) Act 1975 – Severance costs which attaches guidance on a scheme to allow local authorities to borrow to meet severance costs in 2011/12. This scheme provides consent where an authority clearly demonstrates the need to borrow to meet the unavoidable, short term severance costs (i.e. redundancy or early release) resulting from organisational restructuring.

86. Unavoidable costs include redundancy payments under the *Employment Rights Act 1996* and additional payments made to a pension fund as a result of retirement benefits being immediately payable (i.e. 'strain on the fund' costs). Authorities may include the 'strain on the fund' costs where the sums charged by the pension fund for spreading the costs will be significantly more than borrowing elsewhere. Discretionary payments are unlikely to be the subject of a borrowing consent.

87. Authorities are required to submit applications in the form of a business case containing information set out at Annex A to the circular. Decisions will primarily be based on financial need using an affordability test, i.e. the costs to be financed from borrowing should exceed both

- 5% of available reserves anticipated at 31 March 2012; and
- 0.25% of budgeted expenditure for 2011/12.

88. Within three months of each financial year end, the Director of Finance is required to advise the Scottish Government of the actual borrowing undertaken in respect of the consent, and to confirm that such borrowing has been used only for the expenditure as detailed in the consent letter.

89. Where borrowing is undertaken using the consent, a separately identifiable advance from the loans fund should be made. Authorities are required to set out in their applications the repayment period which they consider is appropriate, but this may not exceed 5 years. Capital receipts may be used to meet the cost of the principal element of the loans fund advance.

90. Consents granted may be applied to accrued costs or to provisions. However, should the accrual or provision exceed the actual eligible cost when incurred, an additional statutory repayment of the loan fund advance requires to be made to correct the over-borrowing.

91. Consent may not be used in the same year that there is a revenue contribution to finance the capital programme.

92. Expenditure, for which consent is provided, should be charged to the comprehensive income and expenditure statement. This consent permits the general fund to be credited and the capital adjustment account debited.

93. Local authorities are required to apply for consent by 23 September 2011, and the Scottish Government intends to issue any consents by 16 December 2011.

## Charities

### Reporting requirements from 2010/11

94. As stated at paragraph 28, OSCR has sent a letter to local authorities setting out their reporting requirements from 2010/11 in respect of local authority charities. The letter advises that the minimum requirements for 2010/11 are unchanged, i.e. the following requires to be submitted by 31 December 2011

- For each registered charity with income of less that £100,000, a receipts and payments account and trustees annual report.
- For each registered charity with income in excess of £100,000 or charitable companies, fully accrued accounts in accordance with the charities SORP.

95. Where an initial submission does not include the required accounting statements, OSCR will require the accounts to be revised and re-submitted. Other basic deficiencies in the accounts (e.g. omitting the trustees annual report, or failing to display the charity number) will require to be corrected the following year.

96. These minimum requirements also apply to 2011/12 and 2012/13.

97. Although the letter states that an independent examination report covering each charity is acceptable until 2012/13, OSCR has since advised (see paragraph 31) that an audit report is required in certain circumstances.

## Police and fire

### Consultation on single police authority and fire board

98. The Scottish Government has issued a consultation paper on the establishment of a single Scottish police authority and single Scottish fire and rescue board.

99. The governance proposals include the following

- The existing eight police forces, the Scottish Police Services Authority, and the Scottish Crime and Drug Enforcement Agency to be brought together as a single service governed by a single Scottish police authority.
- The authority will produce a national strategic policing plan, which will be approved by the Scottish Ministers.

- A Chief Constable will lead and manage the service, and will designate a Local Commander for each local council area.
- The Local Commander will have significant delegated authority for policing in the local authority area and will be responsible for developing and delivering a local policing plan.
- The local council will monitor and scrutinise performance against the local policing plan. It will be for each council to determine how best to carry out its responsibilities.

100. It is also proposed that all of the funding currently provided for policing through a variety of different routes should be consolidated into a single funding stream which the Scottish Government will provide to the police authority.

101. Audit responsibilities for the police authority and the service will transfer from the Accounts Commission to the Auditor General.

102. The proposals for a single fire and rescue board are on a similar basis.

### Community justice authorities

#### Remuneration reports

103. The Scottish Government has issued an email that clarifies the approach to remuneration reports in community justice authorities (CJAs). CJAs are not covered by the statutory requirements to publish a remuneration report that apply to local government (see TB 2011/1 - page 38).

104. However, the Scottish Government's view is that CJAs should consider including themselves voluntarily in these arrangements. The e-mail therefore suggests that CJAs consider including a remuneration report in their annual accounts from 2011/12.

## Publications

**The following publications can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

### Corporate governance

#### Briefing note 1 Counting costs - Making costing count: Improvement actions for council managers

105. This briefing from CIPFA is on improving the use of cost information in councils. It highlights research that has shown that understanding costs is an area of weakness in councils e.g.

- Few councils sufficiently understand the costs of their own services to form sound judgements about the relative merits of in-house and contracted service delivery.
- Some councils have entered strategic service delivery partnerships without an adequate formal business case, and few councils have a good grip on the costs of the procurement process.

- Most councils do not have sufficient knowledge of the costs they risk incurring because their population is ageing, and they do not know about the potential savings from preventive and collaborative action.
- Councils do not understand the cost of services sufficiently to know who they are subsidising and when. Managers often present spending information to councillors net of charging income, which obscures the true cost of the service.
- Some councils are not collecting and analysing cost information for decision taking. Other councils fail to turn data into usable information or to share it across departmental boundaries.

**106.** The briefing is designed to help managers and members understand the importance of understanding costs. It includes case studies from the private sector which illustrate how this can help drive down costs and improve performance.

**107.** It concludes that managers need to bring relevant, high-quality cost and performance information together for decision takers and present this in an easy-to-understand form. Managers should begin by being clear about the decisions they want to take, identify the cost information they will need, and then take steps to secure it.

**Holding to account – using local authority financial statements**

**108.** This guide from the Local Authority (Scotland) Accounts Advisory Committee is intended to help elected members scrutinise their local authority's financial statements from 2010/11.

**109.** The guide explains the key elements of a set of financial statements and sets out the role of the statements in corporate governance. It also provides example questions for members to ask on the stewardship of public funds, risks to public resources, and financial sustainability.

## Auditor action

**110.** The following is a summary of items in this chapter of the TB that recommend that auditors take certain actions

| Section and paragraph | Action |
|---|---|
| TSU developments - paragraph 20 | Auditors should have used the TSU note for guidance when reviewing and reporting on local authorities' 2010/11 WGA L-Packs. |
| TSU developments - paragraph 22 | Auditors should use the TSU grant note when auditing local authorities' 2010/11 NDR returns. |
| TSU developments - Paragraph 27 | Auditors are requested to send their ISA 260 written communications in respect of local government bodies for 2010/11 to alewis@audit-scotland.gov.uk |

| Section and paragraph | Action |
|---|---|
| TSU developments - Paragraph 29 | Inhouse auditors wishing to undertake the charities audit in 2010/11should contact jgilchrist@audit-scotland.gov.uk as soon as possible. |
| Other developments - Whole of government accounts Paragraph 64 | Auditors should refer to the Scottish Government guidance when auditing the 2010/11 WGA L-Packs |
| Other developments - Benefits Paragraph 73 | Auditors should have completed module 4 of HBCOUNT as part of the audit of the 2010/11 benefit subsidy claims. |
| Other developments - Benefits Paragraph 76 | Auditors should have completed this e learning training package before undertaking the 2010/11 HB COUNT subsidy audit. |

# Health chapter

## Introduction

**This chapter contains articles on health technical developments and guidance relevant to external auditors' responsibilities under their audit appointment. It should be read by external auditors with appointments in the health sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance and urgent issue notes).**

**The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to inhouse auditors on the TSU intranet.**

**In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that the following article in this chapter relates to 2011/12 audits**

- TSU guidance on consolidation of NHS charitable funds
- NHS workforce changes
- Briefings on the NHS
- Eyecare integration project update
- Withdrawal of recruitment and retention premia
- 2011/12 ophthalmic payments
- 2011/12 general medical services contract.

## TSU developments

### Guidance

**The following article provides an update from the TSU.**

#### Consolidation of NHS charitable funds

111. TB 2011/1 (page 61) advised auditors that the Financial Reporting Advisory Board (FRAB) had agreed to the deferral of the application of *IAS 27 Consolidated and separate financial statements* in respect of linked NHS charities until 2011/12.

112. FRAB has considered this further and the current proposal is for the standard to be applied from 2013/14. This is to allow bodies to achieve consistent and correct application of the standard across the sector.

## Other developments

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

### National agenda/direction

**NHS briefings**

113. The Scottish Parliament Information Centre (SPICe) has published two briefing papers on the the NHS in Scotland.

114. The first briefing National Health Service in Scotland provides an introduction and covers

- a summary of the main NHS reforms since 1997
- the current organisation of the NHS in Scotland
- governance and accountability arrangements
- regulation, inspection and funding mechanisms
- current key issues such as funding pressures, shifting the balance of care, community health partnerships, and workforce issues.

115. The second briefing Health finance provides an overview of how the NHS in Scotland is funded, and highlights the main cost pressures facing the service.

116. The health budget accounts for a third of the total Scottish budget. In the latest budget, the health budget increased by 2% in cash terms (equal to a real terms cut of 1%), compared to a 3% cut in the overall Scottish budget. Illustrative budget figures for the period to 2014/15 indicate that the health budget will continue to rise in cash terms.

117. Around three-quarters of the total health budget is allocated to health boards using the NHSScotland Resource Allocation Committee (NRAC) formula, which reflects demographic and geographic factors and other health related indicators. In practice, the 2011/12 allocations differ from the amounts under the NRAC formula as transitional measures are in place to ensure that no board faces a real terms reduction in funding as a result of the move from the previous Arbuthnott formula.

118. The hospital sector accounts for over half of all NHSScotland expenditure, with the largest areas of spending being staff costs and pharmacy costs, which together account for over three quarters of all hospital and community spending.

119. Cost pressures in the NHS result from increasing demand for services, largely due to an ageing population, and increasing costs of delivery, including staff costs and the cost of drugs and utilities.

120. In 2011/12, the efficiency savings target for the Scottish public sector, including NHSScotland, require savings of £257m across all health boards. This compares with achieved savings of £208m in 2009/10.

**Eyecare integration project update**

121. The Scottish Government Health Directorate (SGHD) has issued PCA(O)(2011)2 to provide an update on the eyecare integration project. The project aims to deliver accessible, appropriate and integrated eyecare services throughout Scotland by

- facilitating direct electronic referrals from optometrists to ophthalmologists
- enabling payment claims to be submitted electronically by optometrists to Practitioner Services Division.

122. Boards are being asked to ensure that 95% of referrals and claims are made electronically by April 2014. The Eyecare Integration Steering Group recommends that IT connections should be implemented in boards' business areas by integration into existing referral processes.

**2011/17 eHealth strategy**

123. The Scottish Government has issued an eHealth strategy 2011-2017 to set out the strategic eHealth aims over the next six years. The strategy reaffirms the Scottish Government's view that information and communication technologies are important in supporting quality improvements in healthcare services, and reinforces a move from a focus on technology towards a focus on benefits and outcomes. It sets out five new strategic eHealth aims, which are to use information and technology in a coordinated way to

- maximise efficient working practices, minimise wasteful variation, bring about measurable savings and ensure value for money
- support people to communicate with the NHS in Scotland, manage their own health and wellbeing, and to become more active participants in the care and services they receive
- contribute to care integration and to support people with long term conditions
- improve the availability of appropriate information for healthcare workers and the tools to use and communicate that information effectively to improve quality
- improve the safety of people taking medicines and their effective use.

124. Boards will progress the five strategic aims over the six years of the strategy, with year one (2011/12) being a shadow year. It is envisaged that from 2012/13, the strategic aims will be incorporated into local delivery plans (LDPs). Aligned to boards' LDPs will be eHealth plans, which will run for three years.

125. The strategy also contains nine short term goals to be delivered by 2014. They include

- boards will have well established programmes to replace paper with digital equivalents
- the eHealth programme will have developed a national strategy covering the range of electronic contact that individuals have with the NHS

- a new health and social care IT strategy will have been developed in partnership with local authorities
- the local use of information for quality improvements will be enhanced by the eHealth programme developing a strategy for real time and near time performance data.
- all territorial boards will be using clinical portals.

126. The strategy will be reviewed and refreshed in 2014, to concur with the next spending review, and deliverables for 2017 will be developed.

127. The new eHealth finance strategy, which was implemented on 1 April 2011, aims to distribute the majority of eHealth funding to boards rather than allocate it on a project by project basis or spend it centrally. There are allocations for

- change programmes to deliver the five strategic eHealth aims
- applications/services enablers i.e. products and services already in use
- infrastructure enablers e.g. Broadband and email

128. A summary of performance against the actions and aims contained in the previous strategy is included as an annex.

## Pay modernisation and workforce planning

### NHS workforce changes

129. The SGHD has issued two reports highlighting changes in the NHS workforce in 2010/11, and those forecast in 2011/12.

130. The first report 25% reduction in senior manager posts target - national progress highlights the progress against the national target to reduce the number of senior managers in post by 25% by April 2015. The overall reduction in 2010/11 was 107.3 whole time equivalent (WTE) posts, which is a drop of 8.1%. Although this is a national target, the figures for individual boards are included as an appendix.

131. These figures differ from other published data on management costs as they exclude posts that are clinically orientated or involve the support of frontline services

132. The second report highlights the potential effect on each board's workforce based on local delivery plans for 2011/12

- There is a projected overall reduction of 2,390.5 WTE posts, which is a reduction of 1.8%.
- The largest estimated reduction is in administration posts with a reduction of 4.3%, including a 9.5% reduction in senior management.
- Medical hospital, community and public health services posts show a 4.1% projected increase of 442.7 WTE. This is mainly due to NHS Education for Scotland taking on the role as employer of GP trainees where the trainees had previously been employed by the GP Practice whilst on placement.

### Withdrawal of recruitment and retention premia

**133.** TB 2011/2 (page 36) advised of the withdrawal of national recruitment and retention premia (NRRP) on 31 March 2011. PCS(AFC)2011/7 has been issued to provide further guidance.

**134.** The circular explains that transitional arrangements apply from 1 April 2011 which allow for 100% protection of the current payment for 2011/12 and 50% for 2012/13.

**135.** There is a commitment that no member of staff should lose out financially and, if the withdrawal of NRRP results in a loss of earnings, boards are required to put appropriate protection arrangements in place. The circular sets out a range of relevant protection arrangements which may be required for the different circumstances that surround the current NRRPs.

### 2011/12 ophthalmic payments

**136.** PCA(O)(2011)3 advises of various payments in respect of ophthalmic services during 2011/12. The letter states that from 1 April 2011

- the allowance paid to supervisors of pre-registration trainees has increased to £3,166
- NHS optical vouchers values remain at the level set from 1 April 2009.

**137.** The letter also advises that the allowance for loss of earnings in respect of continuing education and training undertaken during 2010 is £491.

### 2011/12 general medical services contract

**138.** The SGHD has issued PCA(M)(2011)12 which outlines the key features of the general medical services 2011/12 contract, in particular the key steps required to implement the new quality and outcomes framework (QOF) quality and productivity indicators.

**139.** There will be no uplift to practitioners' net pay in 2011/12, although a contract uplift of 0.5% will support practices in meeting cost increases, including pay increases for staff with a full time equivalent salary of less than £21,000. The uplift will be delivered through an increase in the value of the QOF point.

**140.** New indicators to deliver improvements in the quality of primary care that will potentially reduce emergency hospital admissions and variation in hospital outpatient referrals have been introduced. The points attached to these indicators are improving the cost effectiveness of prescribing (28 QOF points), managing out patient referrals (21 QOF points), and managing emergency admissions (47.5 QOF points). For a practice of average list size, these points are likely to be worth around £12,500.

**141.** The current QOF indicators (58.5 QOF points) attached to the patient experience of 48 hour access and advance booking have been removed.

# Publications

**The following publication can be obtained by using the hyperlink, and is available to inhouse auditors on the TSU intranet.**

## Performance management

### NHS financial year 2010/11 – a summary of auditors work

142. This report from the Audit Commission NHS financial year 2010/11 – a summary of auditors work summarises the findings from the 2010/11 audit of NHS bodies in England. Key findings include the following

- Overall the financial performance continues to be good with a £1.5 billion surplus reported.
- No organisation had its accounts qualified on the grounds of truth and fairness.
- Nine organisations failed to achieve financial balance and three overspent their capital resource limit.
- Forty five organisations received qualified value for money conclusions for
  - weaknesses in financial management and planning
  - a need for financial support
  - the existence of significant levels of unidentified savings in 2011/12 plans
- Most organisations are in a good financial shape to meet the challenges in 2011/12.

### Summary of the NAO's work on the Department of Health 2010/11

143. This briefing from the National Audit Office Summary of the NAO's work on the Department of Health 2010/11 provides a summary of the 2010/11 audit of the Department of Health. Key findings include the following

- The department underspent by 1% against its final revenue delegated expenditure limit and by 42.4% against its final annually managed expenditure (AME) budget in 2010/11. The AME underspend was mainly because the NHS reforms were delayed to allow for a consultation exercise to take place.
- The department aims to deliver up to £20 billion of efficiency savings by the end of 2014/15, including a 33% saving in administrative costs. Work on the locally identified programmes and national workstreams for making the savings began in 2010/11, but delivery is expected to begin in earnest in 2011/12.
- During the last year, a number of areas were identified where financial management and efficiency could be improved including productivity, procurement, challenging the existing use of resources, and the use of information.
- The Department’s resource accounts for 2010/11 received an unqualified opinion. However it failed to meet the Treasury timetable to publish the accounts.

# Central government chapter

## Introduction

**This chapter contains articles on central government technical developments and guidance relevant to external auditors' responsibilities under their audit appointment. It should be read by external auditors with appointments in the central government sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance and urgent issue notes).**

**The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to inhouse auditors on the TSU intranet.**

**In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that the following article in this chapter relates to 2010/11 audits**

- note for guidance on auditing the 2010/11 whole of government accounts
- revised green book
- revised SPFM sections on severance, delegated authority and borrowing.

## TSU developments

### Publications

**The following note has been published by the TSU since TB 2011/2. It can be obtained by using the hyperlink and is available to inhouse auditors from the TSU intranet.**

**Note for guidance on 2010/11 whole of government accounts**

144. The TSU has published Note for guidance 2011/7(CG) 2010/11 whole of government accounts (central government) to provide auditors with guidance on auditing the 2010/11 whole of government accounts (WGA) consolidation packs (C-Packs) of central government bodies.

145. Auditors should have used this guidance when reviewing and reporting on central government bodies' 2010/11 WGA returns.

# Accounting developments

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors from the TSU intranet.**

## Proposed amendments to 2011/12 FReM

146. HM Treasury has issued three exposure drafts which contain proposed changes to the *Government financial reporting manual* (the FReM) from 2011/12.

147. Exposure draft ED/2011/2 IFRIC19: Extinguishing financial liabilities with equity instruments proposes amendments in respect of the applicability of *IFRIC 19 Extinguishing financial liabilities with equity instruments*. IFRIC 19 sets out the accounting treatment for when a body extinguishes a financial liability by issuing equity, rather than settling in cash. It requires the equity to be reported at fair value.

148. The 2011/12 FReM does not currently provide guidance on the applicability of IFRIC 19. The exposure draft proposes that bodies should apply IFRIC 19, without interpretation and adaptation, subject to existing FReM paragraph 9.2.7c which requires investments in other public sector bodies to be reported at historic cost.

149. From 2012/13, the FReM will require investments in other public sector bodies (other than public dividend capital) to be reported at fair value, and therefore IFRIC 19 will apply in full.

150. Comments were required by 15 September 2011.

151. Exposure draft ED/2011/3 Interpretation of IFRS 8 for the public sector context proposes amendments in respect of a department's operating segments. The FReM currently interprets *IFRS 8 Operating segments* so that operating segments for departments should be their agreed departmental strategic objectives (DSOs). As the requirement for DSOs has been removed, the interpretation no longer applies, and the exposure draft outlines two options for applying IFRS 8 to departments.

152. The first option is to apply IFRS 8 without interpretation or adaptation. A department would be responsible for identifying its operating segments in accordance with IFRS 8. This is the Treasury's preferred option.

153. The second option is to interpret IFRS 8 to require disclosure of segment information in a primary financial statement and requiring 100% of expenditure to be covered, rather than 75%

154. Comments should be sent to FReM.consultation@hmtreasury.gov.uk by 23 September 2011.

155. Exposure draft ED/2011/04 Governance statement proposes replacing the statement on internal control with a governance statement which will integrate reporting of governance, risk management and control.

156. Comments should be sent to FReM.consultation@hmtreasury.gov.uk by 10 October 2011.

# Other developments

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

## Investment appraisal

### Revised green book

157. HM Treasury has re-issued The green book: Appraisal and evaluation in central government. This guide sets out the techniques and issues that should be considered when bodies carry out appraisals of new policies and projects before decisions are made, and evaluations after decisions have been made. It is designed to promote efficient policy development and resource allocation across government.

158. The guidance emphasises the need to ensure the proper use of public resources by identifying other possible approaches, and performing an assessment of the costs and benefits for relevant options. Activities covered by the guide include

- policy and programme development to help with decisions on the services to be provided, or on the extent of regulation.
- new or replacement capital projects, and the use or disposal of existing assets
- major procurement decisions.

159. The guide also highlights the need to take account of the wider social costs and benefits of proposals. It has been updated to reflect recent developments in valuing non-market impacts, known as the 'life satisfaction' approach.

## Compensation schemes

### Revised SPFM section

160. The Scottish Government has amended the section of the *Scottish public finance manual* on severance, early retirement and redundancy terms.

161. The revised section requires any proposal to offer a financial consideration to secure the early voluntary release of an employee outwith any approved severance, early retirement or redundancy scheme requires to be referred to the relevant Scottish Government Finance Business Partner (or equivalent) for approval before any offer is made, whether orally or in writing.

162. The benefit structure and terms of compensation schemes provided by sponsored bodies should be broadly in line with the arrangements in place within the core Scottish Government as set out in the Civil service compensation scheme.

163. A sponsored body is required to obtain prior approval from the Scottish Government for a new scheme or changes to a previously approved scheme. The business case presented should include

- the rationale for introducing or changing the scheme
- mitigating action to avoid the need for headcount reductions e.g. recruitment freeze
- the terms, and the rationale for offering any terms other than the contractual minimum
- the estimated annual costs and savings of the scheme, and details of how the costs of the scheme will be funded
- the impact that the restructuring/headcount reduction will have on the paybill.

164. In putting in place arrangements for voluntary exit schemes and in reviewing employees' terms and conditions generally, bodies should consider the interaction of any new proposals with existing contractual terms and the need to ensure flexibility in employment arrangements.

### Finance guidance notes

**New notes**

165. The Scottish Government has issued FGN 2011/2 SPFM amendments to announce the recent substantive amendments to the SPFM which are summarised in the following paragraphs.

166. The section on delegated authority has been updated to provide some guidance on what transactions might be regarded as novel or contentious, e.g.

- Novel would include transactions not previously undertaken by the body or that are not considered to be standard practice.
- Contentious would include transactions where there was doubt as to regularity or propriety, or those considered politically sensitive.

167. The section on borrowing, lending and investment has been updated in respect of loans to the private sector to include requirements to undertake proportionate due diligence culminating in a formal assessment of the borrower's financial standing and whether they are likely to be able to satisfy the terms of the loan. A public sector lender should, where appropriate, seek to establish a security (e.g. a floating charge) covering a loan to the private sector.

168. In addition, as stated at paragraph 160, the section on severance, early retirement and redundancy terms has been updated.

## Auditor action

169. The following is a summary of items in this chapter of the TB that recommend that auditors take certain actions.

| Section and paragraph | Action |
|---|---|
| TSU developments - paragraph 144 | Auditors should have used the TSU note for guidance when reviewing and reporting on central government bodies' 2010/11 WGA C-Packs. |

# Further education chapter

## Introduction

**This chapter contains articles on further education technical developments and guidance relevant to external auditors' responsibilities under their audit appointment. It should be read by external auditors with appointments in the further education sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance and urgent issue notes).**

**The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to inhouse auditors on the TSU intranet.**

**In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that the following article in this chapter relates to 2010/11 audits**

- note for guidance on auditing the 2010/11 financial statements
- new accounts direction
- guidance on 2010/11 financial statements
- 2010/11 early retirement provision discount factor
- 2010/11 model financial statements.

## TSU developments

### Publications

**The following note has been published by the TSU since TB 2011/2. It can be obtained by using the hyperlink and is available to inhouse auditors from the TSU intranet.**

**Note for guidance on 2010/11 further education financial statements**

170. The TSU has published Note for guidance 2011/9(FE) 2010/11 further education financial statements to provide auditors with guidance on risk areas that they should pay particular consideration to when auditing the 2010/11 financial statements.

171. Auditors should use the note for guidance when auditing the 2010/11 financial statements.

## Accounting developments

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

### Accounts direction from 2010/11

172. The Scottish Funding Council (the SFC) has issued their Accounts direction from 2010/11. The accounts direction brings together the formal disclosures that colleges are required to make in their financial statements. The SFC wishes to ensure that the form, content and disclosures within the financial statements follow good practice as well as meeting their requirements.

173. Specific mandatory disclosures are required in Appendix 1 to the direction, and Appendix 2 sets out the corporate governance disclosures required. The direction requires that colleges comply with the *Statement of recommended practice: Accounting for further and higher education* (the SORP) in preparing their financial statements.

174. The changes from the previous direction are minor e.g. references to the *Combined code* have been replaced with the *UK Corporate governance code*.

175. Auditors should confirm that colleges have complied with the accounts direction when auditing the 2010/11 financial statements.

### Guidance on 2010/11 financial statements

176. The SFC has issued Detailed notes for guidance on completion of 2010/11 financial statements to supplement the accounts direction. The guidance covers key disclosures in the financial statements, including model notes and a report on the accounting treatment of local government pension schemes. In certain cases, the additional disclosures are required to reflect the situation in Scotland.

177. The main change is the addition of paragraphs 42 to 44 which have been added to reflect the move to the consumer prices index from the retail prices index (RPI) for updating public sector pensions. In accordance with UITF abstract 48, colleges are required to conclude as to whether there was a constructive obligation to increase pensions in line with RPI. There was uncertainty regarding the appropriate treatment at the time of preparing the 2009/10 accounts and this may involve changing the treatment adopted for that year. Any change may need to be reflected as a prior year adjustment in 2010/11.

178. The guidance also confirms at paragraphs 54 and 55 that colleges will continue to converge with IFRS in line with medium-sized unlisted UK companies. This means that they will apply existing UK GAAP in 2010/11, and it is currently proposed that 2014/15 would be the first year of IFRS implementation.

179. Auditors may wish to refer to the guidance notes when auditing the 2010/11 financial statements.

### 2010/11 early retirement provision discount factor

180. The SFC has advised of the net interest rate that could be used when preparing the early retirement pension provision in 2010/11. It advises that an appropriate rate is 2.0%, which is unchanged from 2009/10.

181. Auditors should confirm their colleges have used an appropriate discount rate when calculating their early retirement pension provision, and that there is reasonable justification if they have used a rate other than the one suggested by the SFC.

### 2010/11 model financial statements

182. The SFC has issued model statements for colleges to use in the preparation of their 2010/11 financial statements.

## Other guidance

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

### Finance

#### 2011/12 childcare funds

183. The SFC has issued SFC/17/2011 National policy: childcare funds for further education and higher education students in Scotland's colleges 2011/12 which announces the 2011/12 childcare funds for colleges.

## Publications

**The following publication can be obtained by using the hyperlink, and is available to inhouse auditors from the TSU intranet.**

#### Briefing from the Scottish Parliament Information Centre

184. This briefing from the Scottish Parliament Information Centre (SPICe) provides an overview of Scotland's college sector. The briefing covers

- the policy background
- governance arrangements
- sources of funding
- student support

## Auditor action

185. The following is a summary of items in this chapter of the TB that recommend that auditors take certain actions.

| Section and paragraph | Action |
| --- | --- |
| TSU developments - paragraph 170 | Auditors should used the TSU note for guidance when auditing the 2010/11 financial statements. |
| Accounting developments - paragraph 172 | Auditors should confirm that colleges have complied with the accounts direction when auditing the 2010/11 financial statements. |
| Accounting developments - paragraph 176 | Auditors may wish to refer to the SFC guidance notes when auditing the 2010/11 financial statements. |
| Accounting developments - paragraph 180 | Auditors should confirm their colleges have used an appropriate discount rate when calculating their 2010/11 early retirement pension provision, and that there is reasonable justification if they have used a rate other than the one suggested by the SFC. |

# Contact points

**Specific enquiries or requests for further information relating to articles contained in each chapter of this TB should be made to**

| Contact | Chapter |
|---|---|
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| Neil Cameron, Manager - Health (Technical)<br>0131 625 1797<br>ncameron@audit-scotland.gov.uk | Health |
| Owen Smith, Manager – Benefits (Technical)<br>0131 625 1914<br>osmith@audit-scotland.gov.uk | Local authority (Benefits articles only) |
| Tim Bridle, Technical Adviser (Local Government)<br>0131 625 1793<br>tbridle@audit-scotland.gov.uk | Local authority |
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**Feedback on this TB should be sent to alewis@audit-scotland.gov.uk**

Technical Services Unit

Audit Scotland

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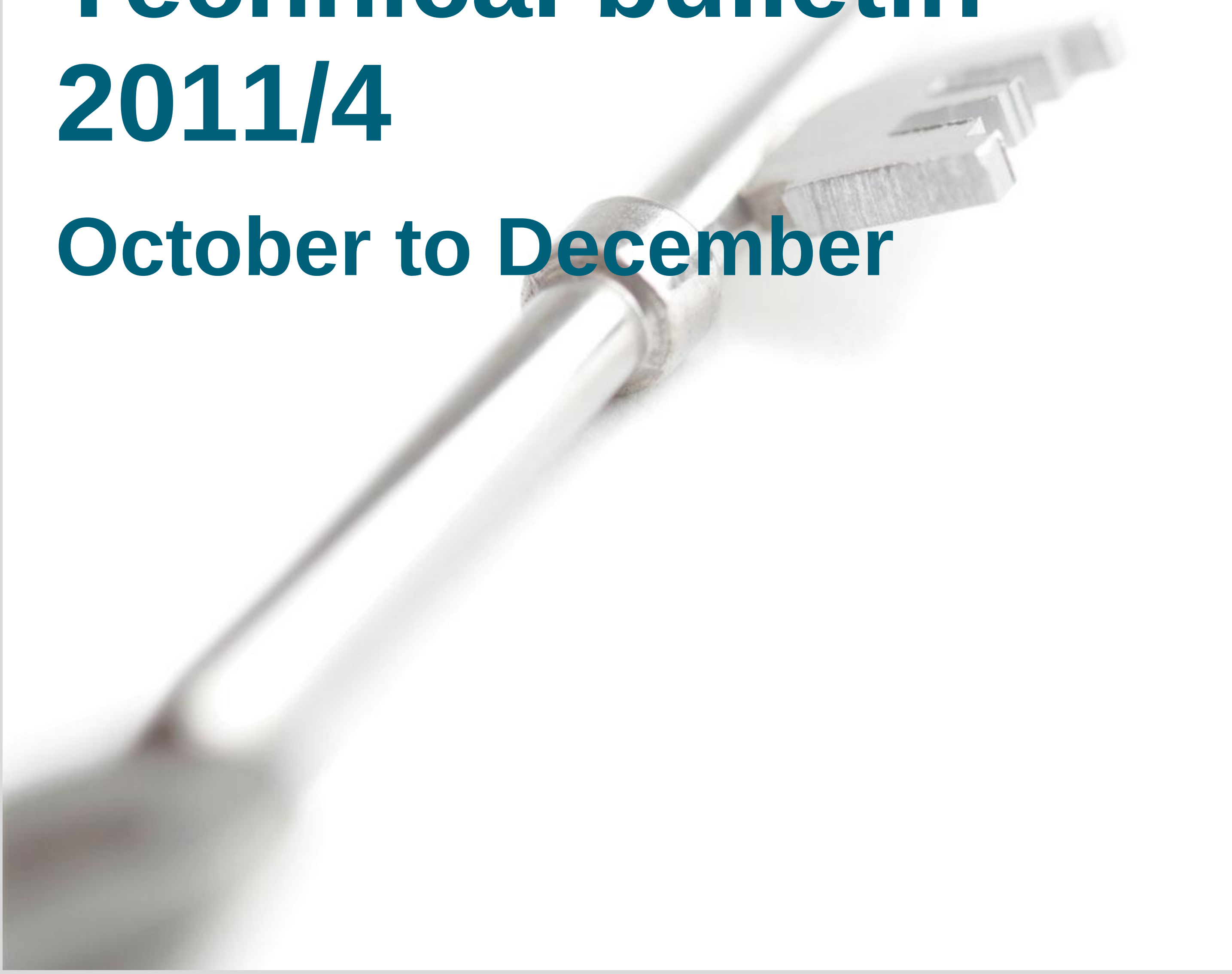
23 September 2011

# Technical bulletin 2011/4

## October to December



AUDIT SCOTLAND

Prepared by the Technical Services Unit
13 December 2011

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

# Contents

# Foreword

Audit Scotland's Technical Services Unit (TSU) provides guidance to external auditors appointed by the Accounts Commission and Auditor General to support them in carrying out their responsibilities under the *Code of audit practice* to

- provide an opinion on audited bodies' financial statements and, where required, the regularity of transactions
- review and report on other information published with the financial statements, including statements on internal control (and equivalent governance statements) and remuneration reports
- examine and report on approved grant claims and other returns submitted by local authorities
- review and report on whole of government accounts returns.

This includes the preparation of technical bulletins (TBs) by the TSU at quarterly intervals, which are approved by the Assistant Auditor General for Scotland, and published onto the TSU intranet and Audit Scotland website. TBs provide a composite of technical developments in the quarter that are relevant to external auditors' responsibilities referred to above, and provide auditors with guidance on any emerging issues. The overall purpose of TBs is to inform auditors' professional judgment in making informed decisions about the courses of action that are appropriate in the circumstances of the audit appointment.

TBs contain information which is of importance to the conduct of audits and frequently recommend that auditors take certain actions, and a summary of these actions is provided at the end of each chapter. It is important that a mechanism is in place for senior audit staff to review the TB promptly and to ensure that steps are taken to consider such recommendations.

While auditors act independently of Audit Scotland, and are responsible for their own conclusions and opinions, consistency of opinions in similar circumstances is important and **it is expected therefore that auditors will normally follow all TSU guidance. Auditors should advise the TSU promptly if they disagree with, and may intend not to follow, any guidance provided on an important issue** (e.g. a matter that requires consideration to be given to modifying the audit opinion on the financial statements of a number of audited bodies).

TBs are also published on the Audit Scotland website so that audited bodies and other stakeholders can be aware of the guidance that has been provided to auditors. TBs should not therefore be regarded as necessarily providing an exhaustive review of all matters relevant to audited bodies.

# Headlines

**The table in this chapter provides brief headlines for the content of this TB, referenced to the paragraphs containing the main article.**

| Cross-sectoral chapter | Reference |
|---|---|
| The TSU has<br>• announced two new members of staff<br>• provided an update on the development of the new Extranet<br>• provided a summary of some reported frauds. | Paragraph 1<br>Paragraph 4<br>Paragraph 36 |
| The International Public Sector Accounting Standards Board has issued<br>• an accounting standard on the accounting requirements of the public sector body in a service concession arrangement<br>• a proposed guideline on reporting on the long-term sustainability of a public sector entity's finances<br>• a consultation paper on a proposed, principles-based framework for reporting service performance information. | Paragraph 6<br>Paragraph 19<br>Paragraph 25 |
| The International Accounting Standards Board has issued a revised draft standard on the financial reporting of revenue from customer contracts. | Paragraph 11 |
| The Chartered Institute of Public Finance and Accountancy has published a revised edition of the treasury management code and cross-sectoral guidance notes. | Paragraph 29 |

| Cross-sectoral chapter | Reference |
|---|---|
| Audit Scotland has issued a report on community planning partnerships. | Paragraph 34 |
| The Scottish Government has issued supporting documents for the 2011/12 autumn budget revision. | Paragraph 35 |

| Local authority chapter | Reference |
|---|---|
| The TSU has published<br>• a note for guidance to provide auditors with guidance on planning and performing the audit of the 2011/12 local authority financial statements.<br>• a note for guidance to provide auditors with guidance on planning and performing the audit of the 2011/12 local authority pension fund financial statements | Paragraph 51<br>Paragraph 55 |
| The TSU provided guidance on<br>• expressing an opinion on the consistency of the explanatory foreword with the financial statements<br>• the inclusion of leisure trusts and trust funds in group financial statements<br>• pension fund governance compliance statements<br>• other statements required to be included with pension fund financial statements<br>• how pension funds should account for the reimbursement and additional pension arising from added years<br>• pension funds recognising a debtor for strain on the fund contributions | Paragraph 58<br>Paragraph 63<br>Paragraph 69<br>Paragraph 73<br>Paragraph 76<br>Paragraph 79 |

| Local authority chapter | Reference |
| --- | --- |
| The TSU has requested submission of outstanding fraud returns or confirmation of nil returns for 2010/11. | Paragraph 82 |
| The Chartered Institute of Public Finance and Accountancy has issued<br>• a revised edition of the prudential code<br>• revised treasury management guidance notes. | Paragraph 85<br>Paragraph 89 |
| The Department for Work and Pensions has issued guidance on risk based verification of benefits claims from 2012/13. | Paragraph 92 |
| The Controller of Audit has issued a section 102 statutory report on Strathclyde Partnership for Transport. | Paragraph 102 |
| The Audit Commission has issued a report on fighting fraud in local government. | Paragraph 103 |

| Health chapter | Reference |
| --- | --- |
| The Scottish Government Health and Social Care Directorates has issued<br>• guidance on accounting for the transfer of responsibility for prisoner healthcare services<br>• updated directions and guidance to health boards on the provision of healthcare in prisons<br>• the statement of financial entitlements for GP contractors for 2011/12<br>• updated payment verification arrangements for all family health service contractor streams for 2011/12 | Paragraph 104<br>Paragraph 108<br>Paragraph 115<br>Paragraph 116 |

| Health chapter | Reference |
|---|---|
| • letters announcing changes to the directed enhanced services programme for 2011/12<br>• a circular advising of changes to the drug tariff<br>• an information assurance strategy for NHS Scotland for 2011 to 2015<br>• a policy on the retention and destruction of patient records<br>• operational procedures for the destruction of personal health records policy<br>• guidance for the secure handling of person identifiable information by third party contractors | Paragraph 119<br>Paragraph 126<br>Paragraph 129<br>Paragraph 131<br>Paragraph 136<br>Paragraph 140 |
| NHS Scotland has issued<br>• a report on a new national specialist transport service<br>• the Chief Executive's annual report 2010/11 | Paragraph 111<br>Paragraph 144 |
| Audit Scotland has issued a report on the review of telehealth. | Paragraph 148 |
| The National Audit Office has issued a report on the achievement of foundation trust status by NHS hospital trusts in England. | Paragraph 149 |

| Central government chapter | Reference |
| --- | --- |
| Treasury has issued exposure drafts of proposed amendments to the 2011/12 *Government financial reporting manual* in respect of<br>• disclosures of median pay multiples<br>• rationalising reporting requirements | <br>Paragraph 152<br>Paragraph 156 |
| The Auditor General has issued section 22 statutory reports on<br>• Registers of Scotland<br>• Crown Office and Procurator Fiscal Service<br>• Disclosure Scotland<br>• Scottish Government consolidated accounts | <br>Paragraph 158<br>Paragraph 162<br>Paragraph 165<br>Paragraph 169 |

| Further education chapter | Reference |
| --- | --- |
| The TSU has requested auditors to send a copy of their 2010/11 ISA 260 communications. | Paragraph 173 |
| The Scottish Funding Council has issued<br>• updated operating and financial review guidance<br>• a circular on student support funds clawback. | <br>Paragraph 175<br>Paragraph 180 |

# Cross-sectoral chapter

## Introduction

**This chapter contains articles on cross-sectoral technical developments and guidance relevant to external auditors' responsibilities under their audit appointment. It should be read by all external auditors. Developments and guidance that are relevant to only one sector are covered in the relevant sector-specific chapter. More in-depth and extensive guidance on particular subjects or themes is provided in separate notes published by the TSU (i.e. notes for guidance, urgent issue notes and, for local authorities, grant notes).**

**The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to inhouse auditors on the TSU intranet.**

**The TSU encourages feedback on this TB. Comments should be sent to alewis@audit-scotland.gov.uk.**

**In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that the following articles in this chapter relate to 2011/12 audits**

- New TSU staff
- Extranet update.

## Other guidance

**The following articles provide other guidance, updates or requests from the TSU.**

### New staff

1. Two new members of staff are joining the TSU team on secondment from 1 January 2012.
2. Alison MacDonald joins as Technical Adviser - Central Government. She replaces Ann-Marie McLaughlin whose two year secondment has ended. Alison is responsible for providing support and guidance to auditors in the central government and further education sectors.
3. Anne Cairns joins as Manager - Benefits (Technical). She replaces Owen Smith as a result of internal promotion. Anne is responsible for
   - providing support and guidance to auditors in the local government sector in respect of housing and council tax benefits
   - managing the collection of fraud information

- managing the benefits performance audit.

**Extranet update**

4. TB 2011/2 (page 4) advised auditors that all information on the Extranet site had been lost with no possibility of recovery, but that there were plans to replace it before the end of this year.

5. However, the TSU has been advised that the new Extranet is not expected to be operational before February 2012. The TSU will keep auditors apprised of progress.

## Accounting developments

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

### New standard on service concession arrangements

6. The International Public Sector Accounting Standards Board (IPSASB) has issued IPSAS 32 Service concession arrangements: Grantor which sets out the accounting requirements of the public sector body in a service concession arrangement.

7. The standard is intended to mirror *IFRIC 12 Service concession arrangements* which sets out the accounting requirements of the private sector operator. The scope, principles for recognition, and terminology are therefore consistent with the applicable guidance in IFRIC 12.

8. However, IPSAS 32 addresses the issues identified in IFRIC 12 from the public sector body'ss point of view as follows

   - The body recognises a financial liability when it is obliged to make a series of payments to the operator for the provision of a service concession asset. Under IFRIC 12, the operator recognises revenue for the construction, development, acquisition, upgrade, and services it provides, and derecognises any asset that it held before entering the service concession arrangement.
   - The body recognises a liability when it grants the operator the right to earn revenue from third-party users of the service concession asset or another revenue-generating asset. Under IFRIC 12, the operator recognises an intangible asset.
   - The body derecognises an asset it grants to the operator and over which it no longer has control. Under IFRIC 12, the operator recognises the asset and a liability in respect of any obligations it has assumed in exchange for the asset.

9. The standard applies for periods beginning on or after 1 January 2014, with earlier application encouraged.

10. The *Government financial reporting manual* (the FReM) already contains an adaptation of IFRIC 12 that applies it to the public sector, which is also adopted by the *Code of practice on*

*local accounting in the UK* (the Code). The decision on whether to adopt IPSAS 32, or make any changes to the adaptation, will be made in due course.

## Revised draft standard on the financial reporting of revenue

11. The International Accounting Standards Board (IASB) has issued ED/2011/6 Revenue from contracts with customers which contains a revised draft standard on the financial reporting of revenue from customer contracts.

12. The exposure draft contains some revisions to the proposals in the original exposure draft (see TB 2011/3 - page 4) as a result of comments received on that draft's consultation. The proposed requirements specify the principles that an entity would apply to report information on the amount, timing and uncertainty of revenue and cash flows arising from its contracts to provide goods or services to customers.

13. The core principle of this revised proposed standard is the same as that of the earlier exposure draft, i.e. an entity would recognise revenue from contracts when it transfers promised goods or services to the customer. The amount of revenue recognised would reflect the consideration to which the entity expects to be entitled in exchange for those goods or services.

14. To apply that principle, an entity would
    - identify the separate performance obligations in the contract with a customer
    - determine the transaction price, and allocate it to the separate performance obligations
    - recognise revenue when the entity satisfies each performance obligation.

15. An entity would recognise the costs of obtaining a contract as expenses, when incurred. If the costs incurred in fulfilling a contract are not eligible for capitalisation, an entity would recognise an asset only if those costs
    - relate directly to a contract
    - generate or enhance resources of the entity that will be used in satisfying performance obligations in the future
    - are expected to be recovered.

16. Changes from the original exposure draft include the following
    - The definition of transaction price has been modified to refer to the amount to which the entity expects to be entitled rather than the expected amount to be received.
    - The effect of a customer's credit risk (i.e. collectability) is no longer reflected in the transaction price.

17. For some contracts, the proposed requirements would have limited effect. However, they differ from current practice in the following ways
    - Contracts for the development of an asset would result in continuous revenue recognition only if the customer controls the asset as it is developed.

- An entity would be required to divide a contract into separate performance obligations for goods or services that are distinct. As a result of those requirements, an entity might separate a contract into units of accounting that differ from those identified in current practice.
- The proposed requirements specify which contract costs an entity would recognise as expenses when incurred and which costs would be capitalised because they give rise to an asset.
- An entity would be required to disclose more information about its contracts with customers than is currently required, including more disaggregated information about recognised revenue and more information about its performance obligations remaining at the end of the reporting period.

18. Comments should be made via the IASB website by 13 March 2012.

## Proposed guideline on financial sustainability reporting

19. The IPSASB has issued Proposed recommended practice guideline: Reporting on the long-term sustainability of a public sector entity's finances to provide guidance on reporting on the long-term sustainability of a public sector entity's finances.

20. The reporting is intended to provide users with information on the impact of decisions, made by the reporting date under current policy, which are not fully reflected in the financial statements.

21. Measures of long-term fiscal sustainability are broader than measures of financial position derived from the financial statements. The core information is projections of inflows and outflows for a selected period. They should take into account

    - commitments related to decisions made by the entity on or before the reporting date that do not meet the recognition criteria for liabilities
    - future taxation receipts, contributions and inter-governmental transfers that do not meet the recognition criteria for assets.

22. It is proposed that the information may be presented in a statement or through graphs, supported by narrative reporting. The narrative information should be in respect of the following three inter-related dimensions of fiscal sustainability

    - Fiscal capacity, which is the ability of an entity to meet financial commitments.
    - Service capacity, which is the extent to which the entity can maintain services at the volume and quality provided at the reporting date.
    - Vulnerability, which is the extent to which an entity is fiscally dependent on funding sources outside its control (e.g. inter-governmental transfers), and the extent to which it has powers to vary existing taxation levels or other revenue sources.

23. The principles, assumptions and approaches to the methodology that underpin the projections should be disclosed.

24. Comments should be made via www.ifac.org by 29 February 2012.

### Consultation on reporting service information

25. The IPSASB has issued Reporting service information - consultation paper which sets out a proposed, principles-based framework for reporting service performance information.

26. The proposed framework includes components of service performance information that are necessary to meet the needs of users. It proposes that a report on service performance should include information on

- the scope of the service performance information reported
- the achievement of the public sector entity's objectives.

27. The paper proposes standardised terminology and provides associated working definitions. It also clarifies that the qualitative characteristics that apply to the financial statements should also apply to service performance information.

28. Comments should be made via www.ifac.org by 15 April 2012.

## Other developments

**The document referred to in the following article can be ordered from CIPFA, and will be available to inhouse auditors on the TSU intranet.**

### Treasury management

**Revised treasury management code**

29. The Chartered Institute of Public Finance and Accountancy (CIPFA) has published a revised edition of the *Treasury management in the public services: Code of practice and cross-sectoral guidance notes*. The main purposes of the treasury management code are to

- assist public sector bodies to develop and maintain clear objectives for their treasury management activities
- emphasise the importance of effective risk management
- encourage value for money
- promote the use of measures of performance.

30. For the purposes of the code, CIPFA has defined treasury management as the management of the body's cash flows, banking, money market and capital market transactions, and the effective control of the associated risks. The code recommends the form of words that bodies should adopt to define the policies and objectives of its treasury management activities. It also sets out a number of treasury management practices (TMPs) that should be adopted.

31. The main change from the previous edition is the addition of a reference to the use of derivatives in respect of interest rate risk management under TMP 1.

32. The accompanying guidance notes provide general background and explanatory information on the issues raised and recommendations made in the code. They also give suggestions for schedules to accompany the code's recommended TMPs and draw attention to features of treasury management that are particular to those individual parts of the public services covered by the code.

33. The code and guidance notes will be available to inhouse auditors from the TSU intranet in due course. It may also be purchased from the CIPFA shop.

# Publications

**The following publications can be obtained by using the hyperlinks.**

## Audit Scotland

### Community planning partnerships

34. This report from Audit Scotland Community planning partnerships examines the contribution of community planning partnerships (CPPs) to economic development. Key messages include

- CPPs have an important role in planning and coordinating improvements to local economies, but some aspects of economic development are better planned at a national or regional level.
- The economic development component of single outcome agreements (SOAs) and local economic development strategies need to be better aligned and based on good information about local economies.
- The reduction in ring-fenced funding and the current economic climate increase the need for CPPs to improve their understanding of the costs of delivering agreed outcomes and what this means for individual partners' budgets.
- Existing accountability arrangements should be used to hold all statutory partners to account for their contribution to delivering SOAs.

## Finance

### Scotland's budget documents – the 2011/12 autumn budget revision

35. This publication from the Scottish Government provides information in support of the 2011/12 autumn budget revision.

# Fraud cases

**The following is a summary of fraud cases at audited bodies that have been reported by auditors to the TSU.**

## Payroll

36. Employees were able to defraud a council of £191,000 over a five year period by claiming for overtime they had not worked. The fraud was possible due to supervisory/managerial staff authorising overtime payments in the knowledge that the time had not been worked. The amount defrauded also includes the misappropriation by the supervisors of income from uplifts of waste. Previous internal audit recommendations regarding controls had not been implemented which facilitated the fraud.

37. The fraud was discovered as a result of an internal audit investigation supplemented by external specialist consultants.

38. Disciplinary action has been taken against the perpetrators, and appropriate controls have been reimposed.

## Thefts

39. Unknown individuals were able to steal six council vehicles worth over £50,000 from a depot. The theft was possible because the keys had been left in the vehicles overnight rather than being secured in the depot key box in accordance with the council's policy requirement. This was considered to be common practice and the council's policy had never been enforced.

40. Following the theft, all managers were reminded of the need to observe council policies. The matter has been reported to the police

## Private funds

41. A senior social worker defrauded £24,000 from five social work clients over an 18 month period. The perpetrator operated bank accounts on behalf of the clients and embezzled monies for own purposes. The fraud was discovered when they were unable to repay funds due on the death of one of the clients, and confessed the fraud to a senior member of staff.

42. The fraud was possible due to a lack of controls over client funds. In addition, the perpetrator has misled colleagues into believing that an audit was undertaken by the DWP.

43. Discussions are ongoing with legal, finance and internal audit to ensure that there is regular review/audit of financial transactions being undertaken by council employees. No staff members are now allowed to be personally named as operators of service users' bank accounts.

44. The perpetrator was prosecuted and sentenced to one year imprisonment.

## Expenditure

45. A nursery provider of pre school services misappropriated over £18,000 from a council by continuing to claim funding for children who had left their nursery. The perpetrator also backdated the start date for some children and claimed for a longer period than was due.

46. The fraud was possible as there were no checks to ensure that the children attended the nursery, and the system relied on the nursery informing the council of any changes. A previous internal audit report had highlighted this risk, and it had been agreed that an annual sample check would be undertaken with parents. However, this was not implemented.

47. The fraud was discovered when an employee noticed that the start date on forms from the nursery had been changed, and subsequent checks with parents on the pre-school register for the nursery revealed that some children had previously left.

## Income

48. A social work employee defrauded a council of over £13,000 by keeping cash they collected from clients to pay social work care bills. The perpetrator was able to put a 'hold' on their accounts and did not pay the money over to the council.

49. The fraud was possible as the sales ledger team accepted an instruction from the perpetrator although the individual had no authority to place accounts on 'hold'. There was also no independent periodic review of sales ledger accounts on 'hold'.

50. The procedures for putting accounts on 'hold', and for their regular review, are being revised. The employee was suspended, but resigned before further action could be taken, and the matter has been reported to the police.

# Local authority chapter

## Introduction

**This chapter contains articles on local authority technical developments and guidance relevant to external auditors' responsibilities under their audit appointment. It should be read by external auditors with appointments in the local authority sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on particular subjects or themes is provided in separate notes published by the TSU (i.e. notes for guidance, urgent issue notes and grant notes).**

**The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to inhouse auditors on the TSU intranet.**

**In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that the following articles in this chapter relate to 2011/12 audits**

- Note for guidance on auditing 2011/12 financial statements.
- Note for guidance on auditing 2011/12 pension fund financial statements.
- TSU guidance on leisure trusts and trust funds in group financial statements; explanatory foreword; governance compliance statements; other required pension fund statements; added years; and strain on the fund debtor.
- Request for submission of fraud returns.

## TSU developments

### Publications

**The following notes have been published by the TSU since TB 2011/3. They can be obtained by using the hyperlinks and are available to inhouse auditors from the TSU intranet.**

**Note for guidance on auditing 2011/12 financial statements**

51. The TSU has published Note for guidance 2011/10(LA) Audit of 2011/12 local authority financial statements to provide auditors with guidance on planning and performing the audit of the 2011/12 local authority financial statements.

52. *ISA 315 Identifying and assessing the risks of material misstatement through understanding the entity and its environment* requires auditors to identify and assess the risks of material misstatement in the financial statements. The TSU has published this note for guidance to assist auditors in meeting that requirement by highlighting the areas that the TSU considers represent a generic risk of material misstatement in the 2011/12 statement of accounts.

53. The risks highlighted in the note include those in respect of the following subjects which are also included as articles in this TB

- The requirement to express an opinion on the consistency of the explanatory foreword with the financial statements (see paragraph 58).
- The inclusion of leisure trusts and trust funds in group financial statements as subsidiaries (see paragraph 63).

54. Auditors should use this note for guidance when planning and performing the audit of the 2011/12 local authority financial statements.

**Note for guidance on auditing 2011/12 pension fund financial statements**

55. The TSU has published separate guidance for auditors on planning and performing the audit of the 2011/12 local authority pension fund financial statements in *Note for guidance 2011/10(LA) Audit of 2011/12 local authority financial statement (Pension funds).*

56. The risks highlighted in this note include those in respect of the following subjects which are also included as articles in this TB

- Governance compliance statement (see paragraph 69)
- Other statements required by the Code (see paragraph 73)
- The accounting treatment of added years (see paragraph 76)
- Recognition of strain on the fund debtors (see paragraph 79).

57. Auditors should use this note for guidance when planning and performing the audit of the 2011/12 local authority pension fund financial statements.

## Other guidance

**The following articles provide other guidance, updates or requests from the TSU.**

**Explanatory foreword - consistency opinion**

58. The Code requires local authorities to publish an explanatory foreword with the financial statements to offer an easily understandable guide to the most significant matters reported. Information provided in the explanatory foreword should reflect the accounting requirements of the Code. It should provide

- an explanation in overall terms of the authority's financial position
- assist in the interpretation of the financial statements, including those for the group

- contain a commentary on the major influences affecting the authority's income and expenditure and cash flow
- include information on the financial needs and resources of the authority.

**59.** The *Companies Act 2006* requires the auditor of a company to state in the auditor's report whether the information given in the directors' report is consistent with the financial statements. Audit Scotland requires appointed auditors in the public sector to also report on this matter, and the explanatory foreword is considered to be the local authority equivalent of the directors' report.

**60.** Auditors are therefore required to read the explanatory foreword and express an opinion in the auditor's report as to whether it is consistent with the financial statements. An inconsistency is anything in the explanatory foreword that contradicts information contained in the audited financial statements.

**61.** Auditors should report an inconsistency in accordance with *ISA 720 Section B The auditor's statutory reporting responsibility in relation to directors' reports* as follows

- If auditors are of the opinion that the information in the explanatory foreword is materially inconsistent with the financial statements, and have been unable to resolve the inconsistency, auditors should state that opinion and describe the inconsistency in the auditor's report.
- If an amendment is necessary to the financial statements, and the authority refuses to make the amendment, auditors should express a modified opinion on the financial statements.

**62.** Auditors are not required to verify, or report on, the completeness of the information in the explanatory foreword. If, however, auditors become aware that required information has been omitted, they should communicate this to the authority.

**Group financial statements - leisure trusts and trust funds**

**63.** The Code requires a local authority to include entities which it controls as subsidiaries in its group financial statements. *SIC 12 Consolidation—Special purpose entities* provides guidance on the treatment of special purpose entities (SPEs) that are created to accomplish a narrow and well-defined objective. In the TSU's view, it is likely that SPEs include local authority leisure trusts.

**64.** SIC 12 sets out the following circumstances that indicate that an authority has control over an SPE and consequently should consolidate the SPE as a subsidiary

- The activities of the SPE are being conducted on behalf of the authority according to its specific business needs so that the authority obtains benefits from the SPE's operation.
- The authority has the decision-making powers to obtain the majority of the benefits of the activities of the SPE.
- The authority has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incidental to the activities of the SPE.

- The authority retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

65. Applying these indicators to the circumstances of the relationship between a local authority and its leisure trust, it is expected that leisure trusts should be included in group financial statements as subsidiaries. As leisure trusts have previously been generally treated as associates, this may require a change in treatment at many authorities.

66. Trust funds should also be included as subsidiaries where their charitable objects coincide with the activities of the authority, and the authority benefits from the operation of the trust fund.

67. There is a perception that these consolidation requirements conflict with the independence of charities as there are legal restrictions over authorities controlling charities. However, the TSU considers that this legal requirement should not impinge on financial reporting requirements, and authorities should consider whether the accounting definition of control is met and account accordingly.

68. Auditors should consider this guidance when obtaining evidence that the group financial statements are free from material misstatement.

**Pension funds - governance compliance statement**

69. *The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008* (the administration regulations) require an administering authority to prepare and publish a governance compliance statement to measure their pension fund governance arrangements against the standards set out in guidance from the Scottish Ministers.

70. The governance compliance statement is part of the governance structure within local government and is considered to be equivalent to the annual governance statement/statement on the system of internal financial control which the Code requires local authorities to include with their own financial statements. Auditors are therefore required to review the governance compliance statement to check whether it complies with the Scottish Ministers guidance and report when it does not.

71. TB 2011/1 (page 20) advised that the administration regulations allow an administering authority the option of giving details of where the governance compliance statement can be obtained rather than including it in the annual report. This would mean that auditors could not refer to the statement in their report on the financial statements and the necessary audit assurance would not be given. Auditors should therefore strongly encourage authorities to include a governance compliance statement in the pension fund annual report.

72. In the TSU's view, the Code's requirements for governance statements in respect of local authorities are superseded by the statutory requirement for pension funds to publish a governance compliance statement, and only that statement requires to be included in the annual report. The TSU does not consider it necessary or desirable for there to be similar statements additional to the governance compliance statement included in the pension fund annual report. Auditors should therefore discourage their administering authorities from also

including either an annual governance statement or a statement on the system of internal financial control in their annual reports.

**Pension funds - other required statements**

73. The Code sets out the accounting requirements for pension funds at section 6.5, which requires a fund account and net assets statement to be included in the annual. However, section 6.5 does not by itself specify all the requirements for preparing pension fund financial statements, and other relevant provisions of the Code apply to the extent they are not superseded by section 6.5.

74. The Code requires a number of statements to be included with a local authority's financial statements and, in the TSU's view, the following also apply to pension fund financial statements

- A statement of responsibilities to set out the responsibilities of the authority and the proper officer in respect of the financial statements.
- An explanatory foreword to provide a guide to the most significant matters reported in the financial statements. The requirement for auditors to express an opinion as to whether the explanatory foreword is consistent with the financial statements also applies.

75. Auditors should confirm that these statements are included with the pension fund financial statements.

**Pension funds - added years**

76. *The Local Government Pension Scheme (Benefits, Membership and Contributions)(Scotland) Regulations 2008* give employing authorities the power to increase the total length of pension fund membership of active members by up to ten years (generally referred to as 'added years').

77. The employing authorities are liable for the additional pension arising from the added years and are required to reimburse the pension funds for this amount. As the liability for the added years relates to the employing authority, the pension fund is effectively acting as an agent. The reimbursement and additional pension should therefore be netted off as an agency transaction, rather than be included in contributions and benefits.

78. Auditors should obtain evidence that the reimbursement and additional pension in respect of added years are accounted for by pension funds as an agency transaction.

**Pension funds - strain on the fund debtor**

79. Where an employing authority makes decisions which result in benefits being paid out to a member early, this results in a 'strain' on the pension fund. The administration regulations permit the administering authority to require the employing authority to make additional payments to cover the resulting strain on the fund costs. The additional payments can be made by either a single payment or, if the administering authority agrees, by instalments over a period not exceeding five years.

80. In the TSU's view, where payments are made by instalment, a debtor for the full amount should be recognised in year one, which should then be reduced as the additional payments are made.

81. Auditors should confirm that a debtor for strain on the fund costs is recognised and obtain evidence that it is free from material misstatement.

**Submission of fraud returns**

82. Auditors are reminded that they are required by the *Code of audit practice* to submit information about instances of fraud and irregularity to the TSU. Under current requirements, auditors of local authorities are required to complete proforma returns for cases of discovered fraud in excess of £5,000. The completed fraud returns should be emailed to the TSU (alewis@audit-scotland.gov.uk) as soon as practicable after the fraud has been discovered.

83. However, very few completed returns have been submitted in respect of 2010/11 or 2011/12 and the TSU is concerned that there may be significant under-reporting. Auditors may wish to check with their audited bodies that the arrangements for them being notified of frauds are continuing to operate properly.

84. Auditors should submit outstanding fraud returns as soon as practicable. Guidelines on the preparation and submission of the returns, along with the proforma, are provided on the TSU intranet. Any firms requiring a proforma, or assistance with their completion, should contact the TSU. Where appropriate, auditors should confirm nil returns for 2010/11.

## Other developments

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet (except where indicated).**

### Prudential framework

**Revised prudential code**

85. CIPFA has published an updated edition of the *Prudential code for capital finance in local authorities* (the prudential code). Local authorities are required by regulation to have regard to the prudential code when carrying out their duties, under Part 7 of the *Local Government in Scotland Act 2003*, to determine and keep under review the maximum amount which they can afford to allocate to capital expenditure.

86. The objectives of the prudential code are to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that authorities have fulfilled these objectives, the prudential code sets out the indicators to be used, and the factors to be taken into account.

87. This edition contains the following minor changes in respect of Scottish authorities

- The definition of finance costs has been extended to include the charges in respect of PFI/PPP arrangements and finance leases required by the statutory guidance issued with finance circular 4/2010 (see TB 2010/2 - page 22).
- Clarification has been added that, in contrast with the rest of the UK, credit arrangements are not treated as the borrowing of money in Scotland but instead are considered to be debt associated with capital financing.

88. The code will be available to inhouse auditors from the TSU intranet in due course. It may also be purchased from the CIPFA shop.

## Treasury management

### Revised treasury management guidance notes

89. CIPFA has published a revised edition of the *Treasury management in the public services – guidance notes for local authorities* which are intended to cover how local authorities could adapt the TMPs set out in the revised treasury management code referred to at paragraph 29. They also draw attention to common practices and current issues particular to the treasury management activities of local authorities.

90. They guidance notes contain minor changes to reflect *The Local Government Investments (Scotland) Regulations 2010* (see TB 2010/2 - page 34).

91. The guidance notes will be available to inhouse auditors from the TSU intranet in due course. They may also be purchased from the CIPFA shop.

## Benefits

### New risk based verification from 2012/13

92. The Department for Work and Pensions has issued HB/CTB circular S11/2011 Risk based verification of HB/CTB claims guidance to provide guidance on risk based verification (RBV) of benefits claims from 2012/13. RBV is a method of applying different levels of checks to benefit claims according to the risk associated with those claims. It assigns a risk rating to each claim, which determines the level of verification required. Greater activity is therefore targeted toward checking those cases deemed to be at highest risk of involving fraud and/or error.

93. The classification of risk groups will be a matter for authorities to decide, but the circular gives the following example

    - Low risk claims, where only essential checks are made, e.g. proof of identity.
    - Medium risk claims, which would be verified in the same way as all claims currently.
    - High risk claims, where enhanced stringency is applied to verification, e.g. credit reference agency checks, visits, increased documentation requirements etc.

94. RBV will be voluntary, but authorities opting to apply it will be required to have a policy, which has been approved by members, detailing the risk profiles, verification standards which will

apply and the minimum number of claims to be checked. The policy should be reviewed annually but should not be changed in-year.

95. Every participating authority requires a robust baseline against which to record the impact of RBV, but the source of this baseline is for authorities to determine. Performance requires to be monitored monthly, and reporting requires to include the percentage of cases in each risk category and the levels of fraud and error detected in each.

96. Failure by an authority to apply verification standards as stipulated in its policy will cause the expenditure to be treated as local authority error. In determining the subsidy implications, the extrapolation of this error will be based on the RBV cases where the error occurred. It is important that systems incorporate a flag to identify RBV cases.

97. Auditors will be required to check during the certification of the subsidy claim that it adheres to authorities' RBV policy. Guidance will be provided by the TSU in the grant note on auditing the 2011/12 subsidy claim.

# Legislation

**The following legislation can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

## Statutory instruments

### Representation of the people

98. The Scottish Local Government Elections Order 2011, SSI 399 came into force on 10 November 2011 and provides for the conduct of local government elections from 3 May 2012.

99. The rules for the conduct of the elections are set out in Schedule 1. They contain some differences from the rules in the 2007 Order, most of which follow amendments made to the parliamentary elections rules.

### Pensions

100. The Local Government Pension Scheme (Miscellaneous Amendments) (Scotland) Regulations 2011, SSI 349 came into force on 14 November 2011 and made numerous amendments to the local government pension scheme regulations.

101. The amendments include the following to the administration regulations

- Regulation 27 is amended to change the date by which administering authorities must have published a governance compliance statement to 14 December 2011.
- Regulation 31A(1)(c) is amended to require that, in the pension fund annual report, the report of the arrangements for the administration of each fund should include details of any borrowings of the funds outstanding at the end of the accounting period.

## Section 102 reports

**Under section 102(1) of the Local Government (Scotland) Act 1973, the Controller of Audit may report to the Accounts Commission on the accounts of local authorities or any matters arising from the accounts. The following report has been prepared since TB 2011/3 and can be obtained by using the hyperlink.**

**Strathclyde Partnership for Transport - Progress report on investigation of expenses and other matters**

102. This report is a follow up to an earlier report into serious issues relating to travel expenses and allegations of misuse of public funds at Strathclyde Partnership for Transport (SPT). This report highlights that

- the auditor has been able to confirm that SPT has successfully implemented a range of new procedures relating to controls over expenses, the use of consultants, conflicts of interests, marketing and publicity and capital projects.
- SPT has taken appropriate steps to consider the case for recovery of expenses that could be considered personal and excessive and has taken a reasonable decision not to pursue it on legal advice.

## Publications

**The following publication can be obtained by using the hyperlink.**

### Corporate governance

**Protecting the public purse 2011: Fighting fraud against local government**

103. This publication from the Audit Commission Protecting the public purse 2011: Fighting fraud against local government focuses on fighting fraud against local government in England. It recommends that councils should

- ensure they keep the capability to investigate fraud that is not related to housing benefit
- improve their use of data, information and intelligence to focus their counter-fraud work
- review personal budgets to ensure safeguarding and whistleblowing arrangements are proportionate to the fraud risk
- follow good practice and match the successes of others.

## Auditor action

**The following is a summary of items in this chapter of the TB that recommend that auditors take certain actions**

| Section and paragraph | Action |
|---|---|
| TSU developments - paragraph 51 | Auditors should use note for guidance 2011/10(LA) when planning and performing the audit of the 2011/12 local authority financial statements. |
| TSU developments - paragraph 55 | Auditors should use note for guidance 2011/11(LA) when planning and performing the audit of the 2011/12 local authority pension fund financial statements |
| TSU developments - Paragraph 58 | Auditors should read the explanatory foreword and express an opinion in the auditor's report as to whether it is consistent with the financial statements. |
| TSU developments - Paragraph 63 | Auditors should consider the guidance on leisure trusts and trust funds when obtaining evidence that the group financial statements are free from material misstatement. |
| TSU developments - paragraph 69 | Auditors should review the governance compliance statement within a pension fund annual report to check whether it complies with the Scottish Ministers guidance and report when it does not. |
| TSU developments - Paragraph 71 | Auditors should strongly encourage administering authorities to include a governance compliance statement in the pension fund annual report. |
| TSU developments - Paragraph 72 | Auditors should discourage their administering authorities from including either an annual governance statement or a statement on the system of internal financial control in their annual reports. |
| TSU developments - Paragraph 73 | Auditors should confirm that a statement of responsibilities and an explanatory foreword are included with the pension fund financial statements. |
| TSU developments - Paragraph 74 | Auditors should read the explanatory foreword with the pension fund financial statements and express an opinion in the auditor's report as to whether it is consistent with the financial statements. |

| Section and paragraph | Action |
|---|---|
| TSU developments - Paragraph 76 | Auditors should obtain evidence that the reimbursement and additional pension in respect of added years are accounted for by pension funds as an agency transaction. |
| TSU developments - Paragraph 79 | Auditors should confirm that a debtor for strain on the fund costs is recognised by the pension fund and obtain evidence that it is free from material misstatement. |
| TSU developments - Paragraph 83 | Auditors may wish to check with their audited bodies that the arrangements for them being notified of frauds are continuing to operate properly. |
| TSU developments - Paragraph 84 | Auditors should submit outstanding fraud returns as soon as practicable.  Where appropriate, auditors should confirm nil returns for 2010/11. |

# Health chapter

## Introduction

**This chapter contains articles on health technical developments and guidance relevant to external auditors' responsibilities under their audit appointment. It should be read by external auditors with appointments in the health sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on particular subjects or themes is provided in separate notes published by the TSU (i.e. notes for guidance and urgent issue notes).**

**The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to inhouse auditors on the TSU intranet.**

**In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that the following articles in this chapter relate to 2011/12 audits**

- Accounting treatment for prisoner healthcare transfer.
- 2011/12 statement of financial entitlements.
- 2011/12 payment verification procedures.
- 2011/12 directed enhanced services.
- Changes to pharmacy remuneration.
- New information assurance strategy.
- New policy and processes for patient records.

## Accounting developments

**The document referred to in the following article is available to inhouse auditors on the TSU intranet.**

### Accounting treatment for prisoner healthcare transfer

104. The Scottish Government Health and Social Care Directorates (SGHSCD) has issued a letter providing guidance on accounting for the transfer of responsibility for prisoner healthcare services from the Scottish Prison Service (SPS) to health boards from 1 November 2011.

105. The transfer of responsibility is a machinery of government change, which the FReM requires to be accounted for using merger accounting. This entails the following

- The results of the prisoner healthcare function require to be brought into the boards' financial statements from the beginning of the financial year, i.e. 1 April 2011. The SPS budget for the seven months to October will be transferred to boards through the normal allocations process so that it will be cost neutral.
- Comparatives require to be restated, and adjusted to achieve uniformity of accounting policies.
- A prior year adjustment requires to be made to boards' opening balance sheets to add transferring assets and liabilities, and adjust the general fund as required.
- Boards are required to disclose
  - that the transfer has taken place
  - a brief description of the transferred function
  - the date of the transfer
  - the name of the transferring body
  - the effect on the financial statements.

106. SPS and the SGHSCD intended providing each board with the information required to enable the restatement of the boards' financial statements by 16 December 2011.

107. Auditors should confirm that boards are aware of this guidance and have arrangements in place to meet the accounting requirements.

## Other developments

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

### National agenda/direction

**New responsibility for healthcare in prisons**

108. The SGHSCD has issued PCA(M)(2011)15 which provides updated directions and guidance to health boards on the provision of healthcare in prisons from 1 November 2011.

109. As stated at paragraph 95, the responsibility for providing healthcare services in prisons transferred to boards on 1 November 2011. The new *Health Board Provision of Healthcare in Prisons (Scotland) Directions 2011* reflect boards new responsibilities and set out the rules to ensure services are consistent across all Scottish prisons.

110. Boards are required to provide services directly through the establishment of a GP practice covering the prison. They may employ practice staff directly as employees or via a primary medical services contractor.

### New national specialist transport service

111. NHS Scotland has issued a report Towards a single national specialist transport service which provides an overview of the strategic plan for a national specialist transport service for Scotland.

112. There are currently the following three national transport services dedicated to the transport of the most vulnerable patients

- Scottish Neonatal Transport Service (SNTS), which is funded jointly by boards
- Transport of Critically Ill and Injured Children Service
- Emergency Medical Retrieval Service.

113. A review of the services has recommended the establishment of a single national specialist transport service managed by the Scottish Ambulance Service. This is intended to enable greater cross collaboration and development, improved maintenance of the required infrastructure, and is expected to deliver efficiency savings.

114. The proposed model will be delivered within existing resources, and the phased transition is expected to take up to two years.

## Pay and workforce planning

### 2011/12 statement of financial entitlements

115. The SGHSCD has issued the statement of financial entitlements (SFE) for GP contractors for 2011/12 with PCA(M)(2011)16. The SFE relates to payments to be made by health boards to a contractor under a general medical services (GMS) contract. The amendments compared with the previous version include the following

- The global sum amount has been increased to £389 million to reflect the increase in the population registered with a GP. The contractor population index has also been adjusted to reflect the increased population.
- The arrangements around the monthly correction factor have been amended to reflect the 0% uplift to be applied in 2011/12.
- New quality and productivity prescribing indicators have been introduced, while the indicators relating to the patient experience of access, which were calculated following the national survey of patients, have been removed.
- The payment arrangements for dispensing practices have been amended to reflect the withdrawal of the concession to dispensing practices that are not registered for VAT. From 1 July 2011, an allowance is available to cover the VAT payable on specified products. A one off registration support payment is paid to practices not covered by transitional arrangements.

### 2011/12 payment verification procedures

116. The SGHSCD has issued updated payment verification arrangements for all family health service contractor streams for 2011/12 with CEL(2011)24. The section on primary medical services contractors has the most significant changes, including the following

- The global sum section has been amended to provide more detail, and reflect the streamlined reporting process.
- There have been minor amendments to the quality and outcomes framework (QOF) section including the reduction in the minimum number of random practice visits within a board area from two practices to one.
- The QOF pre-payment guidance to boards has been included as an appendix to the payment verification procedures.

117. The pharmaceutical procedures have been amended to remove references to the chlamydia treatment public health service which has ceased operating. New arrangements have been included for the verification of cross border flow of prescriptions.

118. Practitioners are required to retain evidence to substantiate the validity of payments. Where a practitioner refuses to cooperate in the payment verification process, they may be in breach of their contract, and boards are expected to take appropriate action.

### 2011/12 directed enhanced services

119. The SGHSCD has issued three letters announcing changes to the directed enhanced services (DES) programme for 2011/12.

120. PCA(M)(2011)13 announces minor amendments which came into force on 24 September 2011. The main change is to the ‘at risk’ groups covered by this year’s influenza and pneumococcal DES.

121. Other minor changes include the following

- The definition of primary medical services contract has been amended to exclude arrangements for the provision of primary medical services in prisons. Boards will not be under a legal duty to offer DESs to providers of primary medical services to prisoners.
- The reference to the osteoporosis DES transitional arrangements has been removed.

122. PCA(M)(2011)14 provides further guidance on the influenza and pneumococcal DES for 2011/12. The key changes from 2010/11 are that, for the influenza vaccination, all pregnant women are now included in the 'at risk' group and poultry workers no longer need to be vaccinated.

123. The payment rates for influenza for those in the 65 and over age group remain unchanged. The different rates apply to all immunisations given, not just those above the threshold.

124. PCA(M)(2011)17 provides an updated template to be used for reporting the palliative care DES, which has been extended to continue in 2011/12. To qualify for a payment for this DES, practices are required to ensure that a patient

- is recorded on the palliative care register
- is assessed and a care plan compiled within two weeks of inclusion on the register
- has an up to date care summary made available to professionals involved in their care
- is assessed when they reach the last days of their life.

125. In order to accommodate an effective closure of the 2011/12 programme, the last date a patient can be added to the register will be 18 March 2012. A new palliative and supportive care DES, focussing on the electronic palliative care summary, will be implemented in April 2012.

**Changes to pharmacy remuneration**

126. The SGHSCD has issued PCA(P)(2011)11 to advise of changes to the drug tariff from 1 October 2011. Remuneration arrangements in respect of pharmaceutical services for patients in care homes will in future be separate from those for patients in the community. In preparation for this, each contractor's existing transitional payment is being split into these two elements. The community element is separated into the following three parts

- 5% will form a new target quality and efficiency payment. An 'electronic claims target rate' of 80% has been set, and each contractor will receive a monthly quality and efficiency payment proportional to the actual level of electronic claims achieved. Contractors will be deemed to have met the electronic claims target rate until the January prescribing period.
- 80% will go to form a new community migration payment.
- The remaining 15% will be redeployed into a single central chronic medication service (CMS) capitation payment pool. The level of payment to each contractor is calculated on the basis of the number of patients registered by each contractor.

127. The CMS is being rolled out as an additional pharmaceutical service. The remuneration for this service is based on simple capitation, with a second phase moving towards full weighted capitation in due course.

128. A strand of the existing community pharmacy funding package will be deployed to reward quality and efficiency activity. It will recognise the efforts of individual contractors to submit electronic reimbursement claims wherever practical. An electronic claims training module is being made available to contractors and a special one off payment will be made to all contractors who certify that their relevant staff have completed this training module by the end November 2011.

## Information management

**New Information assurance strategy**

129. The SGHSCD has issued an information assurance strategy for NHS Scotland for 2011 to 2015 with CEL(2011)26. It sets out the strategic direction for developing information assurance (IA) and embedding the IA culture in NHS Scotland. IA reflects the need for

information to be held securely and appropriately, maintained accurately, and available when necessary. The strategy aims to guide improvement in the availability, integrity and confidentiality of information.

130. The strategy sets out the actions required to deliver successful IA under the following four areas

- Leadership and governance should ensure that responsibilities are assigned from the board and that IA is understood, visible, accessible and embedded in the culture of NHS Scotland. Boards are required to review local arrangements to ensure clear lines of responsibility and accountability.
- A proportionate information risk management approach requires to be embedded in the organisation, and aligned to the boards' corporate risk management framework.
- Policy and operations need to be clearly articulated and based on best practice standards, and continue to evolve to reflect current priorities. Boards are required to develop and support appropriate training for staff and implement information protection software to strengthen their systems.
- Monitoring and compliance mechanisms should provide positive assurance that board policies are implemented effectively and achieving the desired outcomes.

**New policy and processes for patient records**

131. The SGHSCD has issued a Retention and destruction of patient records policy which aims to establish a framework for the safekeeping and eventual disposal of personal health records, regardless of the media on which they are held.

132. A records retention schedule is attached as an appendix and specifies the

- time period from the last date of attendance to the transfer to secondary storage, e.g. adult general records are retained for 6 years after the date of the last entry
- minimum retention period for various health records due to statutory requirements or their administrative value.

133. A records inventory should be established and maintained covering each personal records system that exists.

134. The destruction of patient records should be undertaken in a manner that ensures confidentiality is maintained. Where a decision is taken to destroy records from a particular system, a small sample of records should be transferred to the archive for historical and research purposes.

135. Processes should be established to quality assure the competence of staff identifying records suitable for destruction and contractors involved in the destruction process should be appropriately certified. Records which must not be destroyed are specified within the policy.

136. The SGHSCD has also issued Operational procedures for the destruction of personal health records policy to set out the process for the inspection and destruction of personal health records in paper format.

137. Boards should have a strategy which outlines the plan to move from current paper based records systems to electronic health records and clinical portal systems. In the medium term, boards will be required to scan paper documents in addition to capturing clinical data directly from electronic systems.

138. Currently active records are held at the hospital site for twelve months following the last attendance, before being transferred to secondary storage facilities for retention in accordance with the records retention schedule. The records retention schedule is attached as an appendix.

139. The procedures cover the

- selection and inspection of records
- cross-checking of records to be destroyed with electronic systems
- quality assurance arrangements
- arrangements for the secure destruction of records.

**New guidance on contractor handling of patient records**

140. The SGHSCD has issued CEL(2011)25 to provide guidance for the secure handling of person identifiable information by third party contractors. The guidance aims to ensure that all access to, and handling of, person identifiable information by contractors is in accordance with the IA strategy.

141. Boards are required to only select contractors who provide adequate assurances regarding the safeguards they employ to protect information. Contractors should be obliged to comply with the requirements set out in an annex to the letter, which should be incorporated into contract documentation.

142. Boards are required to develop, and agree with each contractor, a clear set of policies and procedures for handling data, including the scope and type of person identifiable information that may be accessible as part of the contract. All relevant board and contractor staff require to be made aware of these policies and procedures, and appropriate training provided.

143. When communicating information, boards are required to establish the types of information involved and the method of communication used. The storage of patient information on mobile devices should be subject to a risk assessment, comply with the requirements of the eHealth mobile data protection standard, and be approved by the local IT security officer and the Caldicott guardian.

## Performance management

**NHS Chief Executive's annual report**

144. NHS Scotland has issued the NHS Chief Executive's annual report 2010/11 which highlights the progress made in 2010/11 towards delivering the strategic vision set out within the *Quality strategy*. The strategy sets the direction for the way the NHS in Scotland works to ensure a

patient centred approach, and performance against the ambitions identified within the strategy is demonstrated by the HEAT targets.

145. The progress highlighted in the report includes the following

- The abolition of prescription charges.
- Significant reductions in the level of healthcare associated infections.
- Achieving financial balance and delivering £595 million efficiency savings.
- Early delivery of the two cancer waiting times targets.

## Legislation

**The following legislation can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

### Statutory instruments

#### National health service

146. The National Health Service Superannuation etc (Miscellaneous Amendments) (Scotland) Regulations 2011, SSI 364 came into effect from 1 December 2011 and made various minor amendments to the superannuation scheme, pension scheme and injury benefit regulations.

147. The National Health Service (Primary Medical Services Performers Lists)(Scotland) Amendment Regulations 2011, SSI 392 come into force on 21 December 2011 and amend the principal 2004 regulations on primary medical services performers lists. The amendments include

- new definitions regarding the implementation of a new vetting and disclosure scheme
- a revised procedure for making an application for inclusion in the list, and amended procedures for boards when considering an application.
- new grounds on which a board may refuse or defer an application for inclusion on its list
- a requirement for a board to inform other boards of its decision on whether to include an applicant in its list. It allows the other boards to then also include the applicant on their own lists without further enquiry.
- the grounds on which a board may suspend a medical practitioner from the list, and the procedure to be followed.
- a reduction in the time in which a performer must give notice to a board of any occurrence requiring a change in the information recorded on a list.

# Publications

**The following publications can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

## Audit Scotland

### A review of telehealth in Scotland

148. This report Review of telehealth in Scotland examines the arrangements in place to support the development and delivery of telehealth (i.e. the provision of healthcare at a distance using technology) and the benefits and barriers to using it more widely. Key messages include the following

- Boards need to consider the use of telehealth when introducing or redesigning clinical services.
- The Scottish Centre for Telehealth should ensure that its new strategic framework contains specific and measurable objectives for developing telehealth, and a delivery plan with a clear timetable for implementation.
- Greater engagement between senior managers and clinicians is required before telehealth initiatives are introduced, to ensure that the appropriate infrastructure and resources are available.
- Better quality evaluations are required to provide evidence on the effectiveness of telehealth and whether it offers better value for money than traditional patient care.
- Boards should ensure that telehealth initiatives are supported by business cases that consider the long-term clinical, organisational and cost benefits.

## Performance management

### Achievement of foundation trust status by NHS hospital trusts

149. This report by the National Audit Office Achievement of foundation trust status by NHS hospital trusts examines the processes put in place by the Department of Health for the achievement of foundation trust status in England by April 2014.

150. Key findings include the following

- Only 14 foundation trusts had been authorised since the end of 2009. The remaining NHS trusts face more challenges than the early applicants due to financial, quality and governance issues.
- The department has put in place a national framework to monitor progress against milestones and track risks. It is considering what resources the applications process requires, and what scope there may be to streamline it, but there is a clear risk that bottlenecks will lead to delay.
- A number of strategic health authorities have developed robust local performance management systems, but these are not universal and there is scope to learn from them.

- The cost of work being done by trusts in support of foundation trust applications is not known.
- Tackling the financial problems faced by some of the most challenged trusts will require direct intervention by the department, such as long-term loan facilities, debt restructuring, and addressing the affordability of PFI schemes.

## Auditor action

**The following is a summary of items in this chapter of the TB that recommend that auditors take certain actions**

| Section and paragraph | Action |
|---|---|
| Accounting developments - paragraph 104 | Auditors should confirm that boards are aware of the accounting guidance on the transfer of prisoner healthcare and have arrangements in place to meet the requirements. |

# Central government chapter

## Introduction

**This chapter contains articles on central government technical developments and guidance relevant to external auditors' responsibilities under their audit appointment. It should be read by external auditors with appointments in the central government sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on particular subjects or themes is provided in separate notes published by the TSU (i.e. notes for guidance and urgent issue notes).**

**The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to inhouse auditors on the TSU intranet.**

**In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that the following article in this chapter relates to 2011/12 audits**

- proposed amendments to the 2011/12 FReM.

## Accounting developments

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors from the TSU intranet.**

### Proposed amendments to 2011/12 FReM

151. HM Treasury has issued two exposure drafts which contain proposed changes to the FReM from 2011/12.

152. ED(11)05 Implementation of the Hutton review on fair pay proposes amendments in respect of disclosures of median pay multiples. The proposal is to require the disclosure of

- the median earnings of the workforce; and
- the ratio of median earnings to the highest paid Director's earnings.

153. The median workforce earning is the total remuneration of the employee lying in the middle of the linear distribution of the workforce. Total remuneration is the sum of the amounts already required by the FReM to be disclosed for directors, i.e. salary, non-consolidated performance-related pay, and benefits-in-kind. The highest paid director may not necessarily be the Accounting Officer or Chief Executive.

154. The figure for the highest earner should be expressed as a £5,000 banding, and consequently the pay multiple would compare the median point of this banding with the median total remuneration of the body (expressed as an actual figure).

155. The proposed change to the format of the remuneration report is provided at appendix A to the exposure draft. Responses were required by 16 November 2011.

156. ED(11)06 Clear line of sight reform: rationalisation and clarification proposes amendments to rationalise reporting requirements arising from a review of the 2010/11 dry-run annual accounts under the *Clear line of sight project* in England. Proposals include removing the

- disclosure note analysing net operating cost by spending body
- requirement for bodies to analyse intra-government current assets and current liabilities (though this proposal was subsequently withdrawn).

157. Responses were required by 23 November 2011.

## Section 22 reports

**Under section 22(3) of the Public Finance and Accountability (Scotland) Act 2000, the Auditor General may prepare a report to Scottish Ministers on the accounts sent to him by auditors. The following reports have been prepared since TB 2011/3 and can be obtained by using the hyperlinks.**

### 2010/11 audit of Registers of Scotland

158. The Auditor General issued this report 2010/11 audit of Registers of Scotland to bring to Parliament's attention a £3.1 million impairment loss arising from two abandoned IT projects under a strategic partnership agreement (SPA) with an external provider.

159. The body had decided not to proceed with one system designed to process case registration because tests showed that it did not achieve the required level of delivery and accuracy. The second project was expected to provide a content management system but was abandoned due to excessive revenue costs. The total cost of both projects was £6.8 million of which £3.1 million were capital costs and required to be impaired.

160. The auditor has identified that the future of other projects being developed under the SPA remains uncertain.

161. The body has undertaken a number of actions to learn lessons which include

- post project reviews
- staff training to ensure all relevant costs are included in business plans
- annual review of ongoing capital projects to identify impairments
- the preparation of exit and transition strategies for the end of the SPA contract in 2014.

## 2010/11 audit of the Crown Office and Procurator Fiscal Service

162. The Auditor General issued this report 2010/11 audit of the Crown Office and Procurator Fiscal Service to bring to Parliament's attention. an impairment charge of £2.3 million arising from a project to replace the existing case management software being brought to an end

163. The new software was expected to address the weaknesses in the current system and provide improved performance and analysis. However, the body established that system requirements were much greater than expected, and considered the revised costs to be unaffordable. The project was brought to an end and the £2.3 million impairment loss was recognised in the financial statements.

164. The body is carrying out a formal detailed post project review of the project which will include an examination of arrangements for procurement, project management and governance of the project.

## 2010/11 audit of Disclosure Scotland

165. The Auditor General issued this report 2010/11 audit of Disclosure Scotland to bring to Parliament's attention an emphasis of matter paragraph in the auditor's report that draws attention to uncertainty surrounding the £21.3 million valuation of an IT system.

166. The Scottish Government transferred an IT system, that it had procured, to Disclosure Scotland to support the introduction of new disclosure legislation. The new system was designed to build on the existing arrangement which involves an external organisation providing the IT infrastructure and processing transactions, with Disclosure Scotland staff carrying out the vetting process.

167. The performance of the IT system fell significantly short of the standard anticipated and created uncertainty as to the appropriate value of the assets. The external provider has implemented a recovery plan with a clear set of outcomes against which progress can be monitored. A milestone payment due to the external provider when the system went live has been withheld and will be reconsidered taking account of progress made.

168. The body will continue to monitor the implementation of the recovery plan in 2011/12 and use this information to review the recorded value of the IT system for the 2011/12 financial statements.

## 2010/11 audit of the Scottish Government Consolidated Accounts

169. The Auditor General issued this report 2010/11 audit of the Scottish Government Consolidated Accounts to bring to Parliament's attention repayment of European Union (EU) funding of £51 million and further likely repayments currently estimated at £51 million. These repayments arose because Scottish Government procedures at the time of receipt did not meet the standards required to ensure the use of funds complied fully with EU legislation.

170. The need for the repayment was identified by EU audits undertaken between 2003 and 2005. £31 million of the repayment relates to controls over payments from the *European social fund* for assistance under the 2000-2006 *European structural funds* programme.

171. The further likely repayments reflect potential financial corrections to funding from the *European agricultural guarantee fund*. These are likely to arise from the findings of EU audits undertaken between 2005 and 2009 which identified concerns about the quality of control systems and procedures being operated.

172. The Scottish Government has made some important changes to the control environment since the time of the original audits. The effectiveness of arrangements, and the extent to which they comply with requirements, will be tested through an ongoing programme of EU audits. Any continuing or additional deficiencies these identify may lead to further financial corrections in the future.

# Further education chapter

## Introduction

**This chapter contains articles on further education technical developments and guidance relevant to external auditors' responsibilities under their audit appointment. It should be read by external auditors with appointments in the further education sector. Auditors should also read the cross-sectoral chapter which covers developments and guidance that are relevant to all sectors. More in-depth and extensive guidance on specific matters are provided in separate notes published by the TSU (i.e. notes for guidance and urgent issue notes).**

**The articles in this chapter are intended to highlight the main points that the TSU considers auditors require to be aware of in respect of each development. In many cases, it may still be necessary for auditors to read the source material. The documents referred to in the articles can be obtained by using the hyperlinks. They are also available to inhouse auditors on the TSU intranet.**

**In order to help auditors distinguish items of immediate significance from those that are of longer-term relevance, auditors may wish to note that the following article in this chapter relates to 2010/11 audits**

- Request for ISA 260 communication.
- Updated OFR guidance.

## TSU developments

### Other guidance

**This sub-section provides other guidance, updates or requests from the TSU.**

**ISA 260 communications**

173. *ISA 260 Communication with those charged with governance* requires auditors to communicate in writing with those charged with governance regarding significant findings from the audit.

174. In order to enhance the TSU's understanding of the type of technical matters being reported, with a view to informing future notes for guidance, auditors are requested to send a copy of their ISA 260 written communications in respect of further education colleges for 2010/11 to alewis@audit-scotland.gov.uk.

# Accounting developments

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

## Updated OFR guidance

175. The Scottish Funding Council (SFC) has issued updated Operating and financial review guidance on the preparation of the operating and financial review (OFR), which colleges are expected to include as part of their financial statements.

176. The OFR should provide an overview of the college's finances and operations and should take account of the good practice set out in the Accounting Standards Board's reporting statement on the OFR. It should reflect the governing body's view of the college and should be

- focussed on the interests of funders and financial supporters
- forward-looking
- complementary as well as supplementary to the financial statements
- comprehensive, understandable, balanced and neutral, and comparable over time.

177. It should explain the nature, objectives and strategy of the college including relevant key performance indicators. The guidance sets out core performance indicators that colleges may use. It should also explain

- current and future developments and performance
- resources, principal risks and uncertainties, and relationships
- the financial position including long-term financing, treasury policies and objectives and liquidity.

178. This updated version contains only minor changes from the previous version, and includes more recent examples of good practice.

179. Auditors may wish to refer to the guidance when auditing the 2010/11 financial statements.

# Other guidance

**The documents referred to in the following articles can be obtained by using the hyperlinks, and are available to inhouse auditors on the TSU intranet.**

## Finance

### Student support funds clawback

180. SFC/20/2011 Student support: announcement of clawback of 2009/10 funds and in-year management of 2011/12 funds provides information on the clawback of unspent support funds for 2009/10, which will be available for the in-year management of student support funds for 2011/12.

## Auditor action

181. The following is a summary of items in this chapter of the TB that recommend that auditors take certain actions.

| Section and paragraph | Action |
|---|---|
| TSU developments<br>Paragraph 173 | Auditors are requested to send a copy of their ISA 260 written communications in respect of further education colleges for 2010/11 to the TSU. |
| Accounting developments - paragraph 175 | Auditors may wish to refer to the SFC operating and financial review guidance note when auditing the 2010/11 financial statements. |

# Contact points

**Specific enquiries or requests for further information relating to articles contained in each chapter of this TB should be made to**

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